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In the Supreme Court of the United States

OCTOBER TERM, 1979

EXXON CORPORATION,

Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court of Wisconsin

JURISDICTIONAL STATEMENT

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Supreme Court of Wisconsin is reported at 90 Wis.2d 700, 281 N.W.2d 94 (1979); the opinion of the Dane County Circuit Court is reported at CCH Wis. Tax Reports, par. 201-373; and the Decision, Findings of Fact and Conclusions of Law of the Wisconsin Tax Appeals Commission is reported at CCH Wis. Tax Reports, par. 201-223. Copies of the foregoing are set forth, respectively, in Appendices A, B and C at pp. App. 1, App. 34 and App. 66.

JURISDICTION

Jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1257(2), this being an appeal which questions the validity of Wis. Stats. §§71.07(1) and (2) on the ground that they are repugnant to the Constitution of the United States, the validity of which was upheld by the Supreme Court of Wisconsin.

The opinion of the Supreme Court of Wisconsin was filed on July 29, 1979. A remittitur order was entered on August 7, 1979, a copy of which is set forth in Appendix D at p. App. 76. No rehearing was had or requested. The Notice of Appeal was filed with the Supreme Court of Wisconsin on September 21, 1979, a copy of which is set forth in Appendix E at p. App. 77.

Jurisdiction of this Court pursuant to 28 U.S.C. §1257(2) is supported by the following decisions:

Hans Rees' Sons v. *North Carolina,* 283 U.S. 123, 51 S.Ct. 385 (1931)

Butler Bros. v. *McColgan,* 315 U.S. 501, 62 S.Ct. 701 (1942)

Moorman Manufacturing Co. v. *Bair,* 437 U.S. 267, 98 S.Ct. 2340 (1978)

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Commerce Clause (Art. I, §8, cl. 3):

> "The Congress shall have power . . . to regulate commerce with foreign Nations and among the several States, and with the Indian Tribes;"

Due Process Clause (Amend. XIV, §1):

> "[N]or shall any State deprive any person of life, liberty, or property, without due process of law;"

The pertinent parts of Wis. Stats. §§71.07(1) and (2) are set forth in Appendices F and G, p. App. 80 and p. App. 80, respectively.

QUESTIONS PRESENTED

1. Whether the State of Wisconsin's assertion that Appellant's total corporate operations constitute a single unitary business for purposes of state taxation, coupled with some alleged nexus between Appellant's operations within the State and some phase of Appellant's total corporate activities, thereby subjecting virtually all of Appellant's corporate income to apportionment, has rendered Wis. Stats. §71.07(2) invalid under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

2. Whether the State of Wisconsin's assessment of income tax on that portion of Appellant's Exploration and Production functional income derived outside the State from extraction of oil and gas not sold to third parties at the well head, and thereby refusing to allocate such income to situs, constitutes a construction of Wis. Stats. §§71.07(1) and (2) which renders the statute invalid under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

3. Whether the State of Wisconsin's assessment of income tax on that portion of Appellant's Exploration and Production functional income derived outside the State from extracton of oil and gas not sold to third parties at the well head, and thereby refusing to allocate such income to situs, constitutes a construction of Wis. Stats. §§71.07(1) and (2) which renders the statute invalid under the Commerce Clause of the United States Constitution.

STATEMENT OF THE CASE

A. Corporate Organizational History.

Exxon Corporation ("Exxon") was formerly named Standard Oil Company (New Jersey) which prior to the name change in late 1972 was the parent of a wholly owned subsidiary corporation named Humble Oil & Refining Company ("Humble"). At about the time of the name change Humble was merged into Exxon, making Exxon the legal successor to Humble, the original taxpayer in this action.

B. Reporting and Audit Pattern.

Appellant timely filed its Wisconsin corporation income and franchise tax returns for the calendar tax years of 1965 through 1968. These returns were prepared and the computation made on the separate state accounting method. Losses were sustained in all four of these calendar years, and no tax was shown as being due for any of these years. On adverse examination the auditor for the Wisconsin Department of Revenue (the "Department") admitted he could not really challenge the separate accounting results.

The field audit for the years in issue concluded that Appellant "is an integrated oil company" and that since Appellant "is a unitary company and its Wisconsin business is an integral part thereof, formula apportionment of the company's income is mandatory and separate accounting is not permissible." As a result it was found that Appellant was "subject to tax on or measured by additional income of $4,532,155" for the period of 1965 through 1968. Additional taxes in the amount of $316,470.85 were thereby assessed.

C. Appellant's Corporate Structure and Corporate Operational Pattern.

Appellant's corporate organization structure during the years at issue consisted of three parts, Corporate Management, Coordination and Services Management and Operations Management. Corporate Management was composed of a board of directors, an executive committee, a chairman of the board who was also the chief executive officer, a president and various directors-in-charge who were members of the board of directors. The Coordination and Services Management consisted of corporate staff departments with the responsibility of providing the overall specialized corporate services that were needed by the corporation.

Operating Management was responsible for directing the operating activities of the individual functional segments of Appellant which consisted of Exploration and Production, Refining, Marketing, Marine, Coal and Shale Oil, Minerals, and Land Management. Each functional segment was organized into a separate department which operated independently of each other operating segment, and was organized in a way so that it could perform essentially on a stand-alone basis. Each operating department was responsible for its own performance both operationally and financially.

The Exploration and Production functional Department was actually composed of three segments, Exploration, Production and Natural Gas. Exploration had the responsibility for the acquisition of reserves of crude oil and gas. Production was responsible for the operation of all of Appellant's producing oil and gas properties including the operation of the natural gas plants and related facilities. Natural Gas was responsible for the purchase and

sale and distribution of natural gas. These three segments were considered part of the Exploration and Production function by the company for accounting purposes.

The Refining Department was responsible for the profitable operation of Appellant's refineries and associated facilities which manufactured petroleum products, special products and petrochemical feed stocks. The Marketing Department was responsible for the profitable distribution and sale of petroleum products through Appellant's marketing facilities.

Each of the functional operating departments had its own separate management responsible for the proper conduct of departmental operations. Each functional department was a separate profit center. In addition, each department was a separate investment center, and records were maintained for each of these departments to reflect the investments in properties and fixed plant. Each operating department had its own corporate accounting office which recorded and reported the cost analysis and the financial results of its operations.

Appellant did not have any crude oil or natural gas production in the State of Wisconsin, nor did it have any refineries located in the State of Wisconsin. Thus, only Appellant's Marketing Department operated in Wisconsin.

The State of Wisconsin was an expansion marketing area where Appellant was making an entry into a new market. Appellant was not widely known in Wisconsin, had limited facilities in the State and, therefore, was required to make additional investments over a long period of time in order to achieve the market position that would make Wisconsin acceptable as a mature market. During the 1960's results of the marketing operations in Wisconsin were very unsatisfactory and resulted only in losses.

D. Utilization of Third-Party Transfer Prices.

It was the policy of Appellant that the transfer prices or values for products and raw materials passing between the three major functional departments, *i.e.*, Exploration and Production, Refining and Marketing, should be based upon competitive wholesale market prices. As there was no mandatory requirement for crude oil produced by Appellant to flow through its own refineries, nor any requirement that its refined products flowing into Marketing must be produced from Appellant's own crude oil production, such crude was either sold to third parties or transferred to a refinery depending upon which method would be the most economical. The refinery was not interested in the ownership of the crude or the source from which it was produced, but, rather, was concerned only with the quality and type of crude oil that was available. Appellant produced crude oil was always transferred from Production to its Supply Department (a non-profit center for the purchase, sale and distribution of crude oil) and then on to the Refining Department or sold to the third parties on the basis of the posted field price for the field in which the crude was produced plus the applicable tariff for transportation.

A posted field price was a published price which indicated what a company was willing to pay for the crude oil it might buy from a particular field. It applied to all purchases of that particular crude, but it was not a commitment to buy; it was only a publication of the price at which crude oil would be purchased if it was in fact purchased. Supply determined what Humble had to pay in order to buy the crude oil it needed. The posted field prices were printed on bulletins by the company which was purchasing the crude oil, and it was a bona fide competitive price. All dispositions of crude oil by Appellant were made at the posted field price, whether the distribution was a transfer to Appellant's refineries by Supply or a sale to third parties by Supply.

The posted field price was the price utilized by Appellant to pay royalty owners under the leases that permitted Appellant to produce the oil. This price was also used by Appellant to pay for oil purchased from any parties having working interests in any particular wells or leases. Whenever Appellant sold crude oil to third parties the posted field price was used as the sales price. Supply, in turn, when it transferred crude to the Refining Department, transferred it at the posted field price. The posted field price was also utilized for purposes of computing depletion for federal income tax purposes, and for computing the severance tax due to the producing states. This price was likewise used by producing states to determine the income allocable to the well head for state income or franchise tax purposes.

None of Appellant's natural gas went to the Refining Department for product conversion. The only gas that went to the Refining Department was used for fuel consumption and amounted to approximately four percent of Appellant's natural gas. All of the gas sold by Appellant was sold in the states where it was produced. Natural Gas did not have any activities in the State of Wisconsin. All gas sold by Appellant to third parties was sold at a negotiated price pursuant to contract negotiations with the purchaser. All gas purchased by Appellant was also purchased pursuant to negotiated contracts. Any internal transfer of gas by Appellant was based upon third-party contracts in effect at the time of the transfer.

Products transferred from Appellant's Refining Department to its Marketing Department were transferred on the basis of wholesale market prices or some equivalent value usually based on prices quoted in Platt's Oilgram. Platt's Oilgram was a price service that primarily reported the wholesale market prices of various petroleum products

at various points in the United States. These were prices of transactions between unrelated buyers and sellers and were prices at which products were actually changing hands in the trade. During the years 1965 through 1968 products transferred between the Refining Department and the Marketing Department were based on a formula tied to the price in Platt's Oilgram with a discount based upon a large third-party sales contract with Standard Oil of Kentucky. If for any day there was a change in the Platt's price for a product there would be a corresponding change in the transfer price between the Refining Department and the Marketing Department. Other products were also transferred at prices equivalent to third party arm's length prices.

The basic objective of Appellant's transfer pricing system was to provide a basis for valuing transfers which would approximate the same results as if one separate independent company had negotiated with another separate independent company.

E. Accounting Practices In The Petroleum Industry And The Use Thereof By Appellant.

In the oil industry the posted field price was a figure at which crude oil was bought and sold in the market at various places. For accounting purposes that price was used as the measure of profitability and the sales value for crude oil. Multifunctional oil companies used posted field prices as a measure of value in transferring crude oil from their exploration and production functions to their refining departments. Without exception, the oil companies used posted field prices in this manner. These companies also used a transfer price on natural gas which was related to existing third-party contracts.

For accounting purposes to correctly and fairly determine the profits of the exploration and production function, the use of posted field prices on transfers between exploration and production and refining gave a result equivalent to a third-party sale price. For transfers between refining functions and marketing functions of multifunctional oil companies, Platt's Oilgram was principally used to determine the transfer prices. Such a use provided an accounting result equivalent to a third-party sale price which was arms length and fair and reasonable for accounting purposes. For internal accounting purposes, the functional operating departments of a multifunctional oil company were generally treated as separate functional segments.

Appellant's internal accounting and transfer pricing procedures isolated and supported the identification of: (1) income derived at the situs of production for the Exploration and Production Department; (2) income derived at the point of operation for the Refining Department; and (3) income derived at the point of operation for the Marketing Department.

From an accounting standpoint, there was no relationship between the income of the Exploration and Production Department and business done by Appellant in the State of Wisconsin. Under generally accepted principles of accounting, such income was fully earned or derived by the Exploration and Production Department at the point where the oil and gas was available for disposition. Under generally accepted principles of accounting, the Refining and Marketing Departments did not serve either to increase or to decrease the amount of Appellant's Exploration and Production functional income.

HOW THE FEDERAL QUESTIONS WERE RAISED AND DECIDED BELOW

Appellant's Petition For Review by the Wisconsin Tax Appeals Commission (the "Commission"), set forth in Appendix H, p. App. 81, contains the following language in paragraph 3(g) at p. App. 84 thereof:

> "As the result of the Department's method of determining Petitioner's net income under the Wisconsin Statutes, income from Petitioner's business, operations and properties outside the State of Wisconsin has been subjected to taxation in Wisconsin, all in violation of the due process clause of the Fourteenth Amendment to the United States Constitution, and which constitute a burden on interstate commerce in violation of Article I, Section 8(3) of the Commerce Clause of the United States Constitution."

After a hearing on the merits, the Commission rendered its decision, see Appendix C, *infra,* p. App. 66, holding in pertinent part that:

1. Appellant's three main functional operations, Exploration and Production, Refining and Marketing, were each separate unitary businesses;

2. The apportionment formula used by the Department in the audit and assessment was improper in including income from Appellant's Exploration and Production and Refining Departments, and resulted in assessing a tax on extraterritorial income earned by Appellant;

3. An apportionment formula, apportioning income earned by Appellant from its Marketing function within and without the State of Wisconsin would be proper and within the mandate of §71.07(2); and

4. Under the Department's assessment the income of Appellant's Exploration and Production and its Refining functions was subjected to multiple taxation.

The Commission's decision was appealed by the Department to the Circuit Court for Dane County, Wisconsin. That Court rendered a Memorandum Decision, see Appendix B, *infra* p. App. 34, finding that Appellant's total corporate business constituted a single unitary business and that its total corporate income was subject to apportionment. But the Circuit Court also found that all of Appellant's income from its Exploration and Production function was situs income that could not be included in apportionable income by the Department, whether the extracted materials were sold to third parties at the well head or transmitted to Appellant's refineries. In addition, the Court found that the taxation of income from Appellant's crude oil and gas produced and not sold to third parties resulted in double taxation of such income. The Due Process and Commerce Clause constitutional issues had been raised in the Circuit Court.

The Circuit Court's decision was brought before the Wisconsin Supreme Court on cross appeals, with Appellant appealing the decision regarding the unitary business holding and the Department appealing the situs income question.

The Wisconsin Supreme Court reversed the Circuit Court's decision on the situs income issue and affirmed on the single, corporate unitary business issue, see Appendix A, *infra,* p. App. 1.

In discussing the unitary business issue, the Court stated that:

> "The purpose of these sections [Sections 71.07(1) and (2)] is to determine what portion of a taxpayer's income is attributable to activities in the state of Wisconsin, since the opening sentence of sec. 71.07(2) states: 'Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state'." (90 Wis.2d at 710, 281 N.W.2d at 100).

The Court continued:

> "Sec. 71.07(2), Stats., (1967) requires that the apportionment method be used by a taxpayer engaged in business within and without the state when the taxpayer's Wisconsin business is an integral part of a unitary business. *Celon Co.* v. *Dept. of Taxation,* 269 Wis. 372, 377-78, 69 N.W.2d 453 (1955). The statute sets forth ratios for the apportionment method but gives the department considerable latitude in adopting a formula which will most accurately reflect a reasonable and equitable tax on the income earned in Wisconsin. *Interstate Finance Corp., supra* at 271-272. [28 Wis.2d 262, 137 N.W.2d 38 (1965)] This court has held that the latitude of the statute itself is not unconstitutional as arbitrary or unreasonable or taxing extraterritorial income, although the application of the statute in some instances might be. *Id.* at 272." (90 Wis.2d at 711-12, 281 N.W.2d at 100-01).

Finally the Court held that:

> "We hold that the taxpayer's Wisconsin operations were an integral part of a unitary business within the meaning of sec. 71.07(2), Stats. (1967). Thus, its income was subject to apportionment under the statutory formula." (90 Wis.2d at 721-22, 281 N.W.2d at 105-06).

In deciding the situs income issue, the Wisconsin Supreme Court stated:

> "The question remains whether the state's effort to reach income from the taxpayer's refining and ex-

ploration and production departments comports with the constitutional requirements of the Due Process and Commerce Clauses.'' (90 Wis.2d at 724, 281 N.W.2d at 107).

The Wisconsin Supreme Court found that the situs income from oil and gas not sold to third parties was part of the unitary stream, and, therefore, was apportionable, and in concluding stated:

> ''The taxpayer's activities have a 'substantial nexus' with the state, as demonstrated by Wisconsin sales of $60,073,293 for the four year period of refined petroleum products and automotive accessories. As discussed above, the tax is fairly apportioned to represent only that part of the taxpayer's income which can be attributed to its Wisconsin activities. There has been no claim that the tax discriminates between interstate and intrastate commerce. Finally, the tax is 'fairly related to services provided by the State.' As the Supreme Court noted in *Japan Line, Ltd.. supra,* at 4480, [..... U.S. ....., 99 S.Ct. 1813, 1820 (1979)] such benefits 'include not only police and fire protection, but the benefits of a trained work force and the advantages of a civilized society.'
>
> ''The fact that the producing states may impose production taxes which are a form of property tax or severance taxes which have been held to be occupation taxes or property taxes does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income.'' (footnotes omitted) (90 Wis.2d at 729, 731, 281 N.W.2d at 110-11).

In further support of its position, the Supreme Court of Wisconsin stated ''That Humble reported losses for its Wisconsin operations for the disputed years is immaterial'' (90 Wis.2d at 720 and 281 N.W.2d at 105) and that ''More importantly, the idea of separate functional accounting seems to be incompatible with the 'very essence of formulary apportionment' * * *'' (90 Wis. 2d at 726, 281 N.W.2d at 109). Without having in any way challenged the accuracy or validity of Appellant's separate functional accounting, the Wisconsin Supreme Court thus summarily precluded Appellant from any opportunity of rebutting the taxing consequences which automatically flowed from the unitary *per se* doctrine adopted by the Wisconsin Supreme Court. The Wisconsin Supreme Court attempted to bolster its position by asserting, arithmetically, that the constitutional measure of the State's right to tax is determined by its ''fair share'' of the taxpayer's income rather than by relevance to the activities of the taxpayer in the taxing state:

> ''Using the figures from Exhibit thirty-five, Wisconsin sales for the four years represented .41 percent of total company sales ($60,073,293 divided by $14,-648,694,678). Wisconsin assessed taxable income for the four years represented .22 percent of total company net income adjusted to a Wisconsin basis ($4,532,-155 divided by $2,022,206,871). Wisconsin can hardly be accused or reaching out for more than its fair share of the taxpayer's income.'' (90 Wis.2d at 729, 281 N.W.2d at 110).

From this decision Appellant has appealed to this Court. The decision of the Wisconsin Supreme Court in favor of the validity of the Wisconsin taxing statutes as applied by the Department in the face of Appellant's claims of invalidity, as so applied, under the Due Process and Commerce Clauses in the United States Constitution, raises valid and substantial Federal questions.

THE FEDERAL QUESTIONS ARE SUBSTANTIAL

The Federal questions presented are not only substantial but they are basically issues of first impression, such as to require plenary consideration, with briefs on the merits and oral argument, for their resolution. Appellant *is not* raising such timeworn issues as (1) the right of a state to tax income derived in that state from operations of a multi-state corporation, (2) the right of a state

under appropriate circumstances to employ an appropriate apportionment formula, or (3) the validity of the three factor formula of Wisconsin when properly applied. The new and substantial issues which are raised and challenged in this appeal, elaborated on below, may be summarized as follows: (a) the concept that a total corporate entity is, as a matter of law, unitary *per se,* thereby authorizing the application of an apportionment formula to virtually all the total corporate income based on a minimal nexus to certain corporate activities in the taxing state; (b) the concept that situs income, other than that resulting from out of state, third party sales, becomes a part of the total unitary income and, hence, subject to the application of an apportionment formula; (c) the concept that a state is entitled to tax its "fair share" of total corporate income regardless of its relevance to the activities of that corporation in the taxing state; (d) the concept that multiple taxation as a burden on interstate commerce depends on the fact, rather than on the power, of a situs state to tax; (e) the concept that if a tax is imposed by a situs state with respect to situs operations, no multiple taxation as a burden on interstate commerce results unless the tax of the situs state is of the same type as that imposed by the non-situs, apportioning state; (f) the necessity, resulting from the foregoing concepts of the Supreme Court of Wisconsin, of this Court reversing the law, as pronounced by the Wisconsin Supreme Court, so as to articulate the law of state taxation in a manner consistent with unanimously contrary pronouncements by other state supreme courts and lower Federal courts; and (g) the determination that, by virtue of the foregoing concepts, the application of the apportionment formula under the Wisconsin statute, as approved by the Wisconsin Supreme Court, automatically results in multiple taxation and a burden on interstate commerce. As noted above, all of these new and substantial Federal questions involve either the Due Process Clause or the Interstate Commerce Clause or both.

I. The Wisconsin Supreme Court, By Finding That Appellant's Total Corporate Business Was Unitary, Has Interpreted Wis. Stats. §71.07(2) In A Manner That Violates The Due Process Clause Of The Fourteenth Amendment To The United States Constitution.

Section 71.07(2) reads, in part, as follows:

> "Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business * * *."

In interpreting this particular statutory provision, the Wisconsin Supreme Court relied primarily on the decisions of this Court in *Hans Rees' Sons* v. *North Carolina,* 283 U.S. 123, 51 S. Ct. 385 (1931) and *Butler Brothers* v. *McColgan,* 315 U.S. 501, 62 S.Ct. 701 (1942), two cases producing utterly different factual and taxation results. The Wisconsin Supreme Court, however, asserted that both of these cases stood for the proposition that:

> "* * * the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits." (90 Wis. 2d at 718, 281 N.W.2d at 104).

With this somewhat simplified view of the holdings in those two cases, and with the knowledge that Appellant's Marketing Department engaged in activities in Wisconsin, the Wisconsin Supreme Court found, *as a matter of law,* that Appellant was a single corporate unitary business and

that its Wisconsin operations were an integral part thereof within the meaning of Section 71.07(2), and that, therefore, virtually its total corporate income was subject to apportionment under the Wisconsin statutory formula. What the Wisconsin Supreme Court did was to make a determination that Appellant was engaged in the business of manufacturing and selling, and that it was, therefore, unitary *per se* and, hence, subject to having virtually its total corporate income included in the apportionment formula simply because of its very limited marketing activities in Wisconsin.

This unitary *per se* approach is certainly a novel one in state taxation, and does not pass constitutional muster under the Due Process Clause of the Fourteenth Amendment to the United States Constitution when compared to all other decisions of this Court. Only four decisions of this Court have even touched on the "unitary" concept in connection with state taxation, and none of these decisions lend support to the Wisconsin Supreme Court's unique unitary *per se* concept.

In *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271, 45 S.Ct. 82 (1924), this Court was presented with a challenge to the constitutional validity of a New York statute providing for an annual franchise or privilege of doing business tax in New York on foreign corporations. This tax was measured by the net income of the corporation, and the tax was determined by the proportion of the value of certain assets within the state compared to the total value of all such assets located everywhere. This Court found that Bass, Ratcliff was engaged in the unitary business of manufacturing and selling ale, that the practice of manufacturing resulted in no profits until there were sales, and that as such the State Tax Commission was justified in attributing to New York for taxation a just proportion of the profits earned by Bass, Ratcliff from the unitary business. This Court pointed out that it did not believe that the application of New York's statutory taxation method produced an unreasonable result or was inherently arbitrary or an attempt to reach profits earned elsewhere. It was stressed that there was no evidence in the record to determine if Bass, Ratcliff had received any net income from its New York business or the amount of any profit or loss on that business when either considered separately or together with the manufacturing business done in Great Britain. Notably, the controlling factor was the facts, or lack thereof, not any basic "unitary" concept.

In *Hans Rees' Sons* v. *North Carolina, supra,* this Court considered a challenge to the North Carolina income tax as assessed against Hans Rees' pursuant to a single factor (property) apportionment formula. Hans Rees' was a New York corporation engaged in the business of tanning, manufacturing and selling leather. The taxpayer had a manufacturing plant located in North Carolina. Its sales office was located in New York. Sales were made throughout the United States and abroad. Some sales were also made in North Carolina. Hans Rees' established that the income from its business was derived from three sources: (1) buying profit, (2) manufacturing profit, and (3) selling profit. The record also established that for the years in issue, the average income with its source in the manufacturing and tanning operations within North Carolina was 17 percent. The state of North Carolina had, pursuant to its statutory method, for the years in question assessed between 66 and 85 percent of Hans Rees' income to the state. This Court was of the opinion that, when a corporation manufacturers in one state and sells in another, the net profits of the entire transaction, as a unitary business,

could not be attributed, *regardless of the evidence,* to either state. In elaborating on this position this Court stated:

> "Undoubtedly the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits. The difficulty of making an exact apportionment is apparent, and hence, when the state has adopted a method not intrinsically arbitrary, it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases. But the fact that the corporate enterprise is a unitary one, in the sense that the ultimate gain is derived from the entire business, does not mean that for the purpose of taxation the activities which are conducted in different jurisdictions are to be regarded as 'component parts of a single unit' so that the entire income may be taxed in one state regardless of the extent to which it may be derived from the conduct of the enterprise in another state. As was said in the Bass Case with regard to 'the unitary business of manufacturing and selling ale' which began with manufacturing in England and ended in sales in New York, that state 'was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business.' And the principle that was recognized in National Leather Company v. Massachusetts, supra, was that a tax could lawfully be imposed upon a foreign corporation with respect to 'the proportionate part of its total net income which is attributable to the business carried on within the State.' When, as in this case, there are different taxing jurisdictions, each competent to lay a tax with respect to what lies within, and is done within, its own borders, and the question is necessarily one of apportionment, evidence may always be received which tends to show that a state has applied a method, which, albeit fair on its face, operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction." (283 U.S. at 133-34).

From the above quote, it is obvious that this Court rejected a unitary *per se* concept, and this concept has not been approved in any subsequent decisions.

In *Butler Brothers* v. *McColgan,* 315 U.S. 501, 62 S.Ct. 704 (1942), the taxpayer contested an assessment under the California Franchise Tax, which is assessed against a corporation's net income as attributed to the state by an apportionment formula. Butler Brothers was an Illinois corporation qualified to do business in California with its home office in Chicago, Illinois, and it was engaged in the wholesale dry goods and general merchandise business, purchasing from manufacturers and selling to retailers. It maintained a wholesale distributing house in California and all receipts from sales in California were credited to the San Francisco house for the period in question by deducting from the gross sales receipts in California, the cost of such merchandise, the direct expenses of the San Francisco house and the indirect expense allocated to it. This resulted in a loss. The California Tax Commissioner, utilizing an apportionment formula consisting of property, wages, and sales, allocated 8.1 percent of Butler Brothers' total corporate net income to California. The taxpayer contended that by use of this formula California had converted a substantial loss into a profit, and that the difference had either been created out of nothing or had been apportioned by California from other states. This Court did not accept Butler Brothers' position. In finding that Butler Brothers was a unitary business, relying primarily on *Hans Rees'* and *Bass, Ratcliff,* and in affirming the tax imposed by California, this Court stated:

> "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed. See Norfolk & Western Ry. Co. v. North Carolina, 297 U.S. 682, 688, 56 S.Ct. 625, 628, 80 L. Ed.

977. This Court held in Hans Rees' Sons, Inc., v. North Carolina, supra, 283 U.S. page 135, 51 S.Ct. page 389, 75 L. Ed. 879, that that burden had been maintained on a showing by the taxpayer that 'in any aspect of the evidence' its income attributable to North Carolina was 'out of all appropriate proportion to the business' transacted by the taxpayer in that State. No such showing has been made here." (315 U.S. at 507).

This Court went on to stress that Butler Brothers had not shown the precise sources of its net income, and had not shown any factors responsible for that income being earned in states other than California. It was also emphasized that no showing had been made that income unconnected with the unitary business had been included in the formula by California.

This Court's most recent opinion regarding state taxation of an interstate business by means of an apportionment formula was rendered in *Moorman Manufacturing Co.* v. *Bair,* 437 U.S. 267, 98 S.Ct. 2340 (1978). Moorman, an Illinois corporation, was engaged in the manufacturing and sale of animal feeds. It sold products to Iowa customers through salesmen and from warehouses in the state. All of the product was manufactured in Illinois. The Iowa apportionment formula is a single-factor formula utilizing sales. Under the Iowa statute the income attributable to Iowa is determined by first eliminating income allocable to other states. From the remaining income, that attributable to business done in Iowa is calculated by taking that proportion of the gross sales made within the state to total gross sales. Moorman challenged the constitutionality of the Iowa single factor formula, and the trial court held the formula invalid under the Due Process and Commerce Clauses of the United States Constitution. The Supreme Court of Iowa reversed, and the case then came

before this Court. This Court, in responding to Moorman's contention that Iowa's single factor formula resulted in the taxation of extraterritorial income in violation of the Due Process Clause, stated:

> "Appellant does not suggest that it has shown that a significant portion of the income attributed to Iowa in fact was generated by its Illinois operations; the record does not contain any separate accounting analysis showing what portion of appellant's profits was attributable to sales, to manufacturing, or to any other phase of the company's operations." (437 U.S. at 272).

Further on in its opinion this Court stated:

> "The Iowa statute afforded appellant an opportunity to demonstrate that the single-factor formula produced an arbitrary result in its case. But this record contains no such showing and therefore the Director's assessment is not subject to challenge under the Due Process Clause." (437 U.S. at 275).

In the above quotes from *Moorman,* this Court has set forth the framework necessary to establish a Due Process violation for a multi-state business challenging a state's apportionment formula. *Moorman* thus acknowledges that separate functional accounting may be used by a taxpayer to identify the income or profits from the various phases or functions of the company's operations and thereby establish that the income attributed to a given state is "out of all appropriate proportion to the business transacted . . . in that state." *Hans Rees' Sons, supra,* 283 U.S. at 135. It should be noted that the Wisconsin Supreme Court rejected this functional accounting approach by stating that it was merely *dicta,* thus ignoring this Court's prescription for finding a Due Process violation. In the record, Moorman made no attempt to establish the profits or income of its manufacturing operation in Illinois, and without such a record this Court could not find that Iowa had taxed extraterritorial income.

In the present case Appellant has done exactly what this Court indicated Moorman should have done in order to establish the taxation of extraterritorial income. By separate functional accounting, Appellant has shown the net income for all three of its functional operations. In Schedule A to Exhibit 28, see Appendix I at p. App. 86, Appellant set forth, for the years in issue, its Wisconsin results on a separate accounting basis, and taxable income and tax for each year if apportionment is used for its Marketing function, and for its Marketing and Refining functions; and its taxable income and tax if its Exploration and Production function is treated as a separate segment or is allocated to situs. This schedule shows that there is a spread of approximately 2.5 million dollars between the income taxable by Wisconsin if Exploration and Production income is allocated to situs and the income the State here attempts to pull in and tax under its apportionment method.

In addition, the testimony of Appellant's witnesses established that Appellant's operational functions were conducted and were accounted for as separate segments of its total enterprise and that the Exploration and Production Department income was all earned outside of Wisconsin from activities outside Wisconsin. The Department offered no contrary evidence. By functional separate accounting, and also by separate accounting for Wisconsin operations, Appellant has proven that extraterritorial income (from Exploration and Production and Refining operations) has been included in the Wisconsin apportionment formula, thereby resulting in a Due Process Clause violation.

Moreover, the fact that Wisconsin's apportionment formula, as applied by the Department, attempts to tax income out of all appropriate proportion to the business transacted by Appellant in the state is conclusively demonstrated by Exhibit 29, set forth in Appendix J at p. App. 87. This shows that Appellant earned a 3.2 percent average return on sales during the years in issue in its company-wide marketing operations, which include both the more profitable so-called mature areas and the less profitable and unprofitable so-called expansion areas. All the testimony and the separate accounting, which the Department's witnesses acknowledged they could not refute, indicated that Wisconsin was in the expansion marketing area classification. Despite this, the Department's assessment attributes to Wisconsin marketing (Appellant's only Wisconsin activity), an average return for the years in issue equal to 7.5 percent of sales, which is approximately 2½ times the company-wide experience including the profitable mature areas for the same period.

What could better demonstrate factually that the Department's assessment is an overreach which attempts to subject to Wisconsin taxation income out of all appropriate proportion to the business transacted by Appellant in the State? Thus, when considered with the unrefuted functional and Wisconsin separate accounting results, Appellant succeeds under this Court's *Moorman* criteria in establishing an unconstitutional overreach. This Court's prescription in *Moorman,* which the Wisconsin Supreme Court chose to ignore, is clearly filled to the requisite standard by Appellant's record in the present case.

Therefore, within the framework established by this Court in *Bass, Hans Rees', Butler Brothers* and *Moorman,* the decision of the Wisconsin Supreme Court and its unitary *per se* concept cannot stand. None of these decisions has reached a finding of unitary *per se.* A finding of unitary at the very most presents merely a condition precedent to the right to apply an apportionment formula to the income of that so-called unitary business, providing that

the taxpayer is unable to show either that all or part of that income is not subject to taxation as not being attributable to business done in the state, or that the resulting tax may be out of all proportion to business conducted in the state. In *Bass, Butler Brothers* and *Moorman* the taxpayer's proof was not sufficient to overcome the condition precedent. However, in *Hans Rees'* it was, and this Court struck down North Carolina's method of taxation as unconstitutional. The opinion of the Wisconsin Supreme Court has even less constitutional validity when the facts in *Bass, Hans Rees', Butler Brothers* and *Moorman* are compared to those in the present case.

Bass, Hans Rees' and *Moorman* involved businesses engaged in manufacturing and selling, and *Butler Brothers* was a business engaged in purchasing and selling. None of these cases concerned a vertically integrated petroleum company operating under the principle of functional profitability independence, as is more specifically described in the State of the Case. Appellant's structure, with its separate internal functional and Wisconsin accounting, makes the unitary *per se* concept expressed by the Wisconsin Supreme Court wholly indefensible under this Court's decisions.

II. The Assessment Of Wisconsin Tax On Income Derived From Appellant's Exploration And Production Functional Operations Outside The State From Extraction Of Oil And Gas Not Sold To Third Parties At The Well Head Constitutes A Construction Of Wis. Stats. §§ 71.07(1) And (2) Which Violates The Due Process Clause Of The Fourteenth Amendment To The United States Constitution.

In the trial record Appellant established that, pursuant to its accounting practices and those of the industry, all of the income of its Exploration and Production Department was calculated from third party sales of gas, from actual transfers of crude oil to third parties at posted field prices or from internal transfers between its Exploration and Production Department and its Refining Department based upon the arms length posted field prices utilized in the industry. The record established that the crude oil that went to Appellant's refineries was produced outside Wisconsin and was transferred outside Wisconsin. The total income, therefore, was derived at the situs of the Exploration and Production activities and, under the Wisconsin Statute had to be so allocated, and not apportioned, as all such activities occurred outside of Wisconsin.

This Court held in *National Bellas Hess, Inc.* v. *Department of Revenue,* 386 U.S. 753, 87 S.Ct. 1389 (1967), that a state may not impose a tax unless there is some minimum connection between the activities of the taxpayer in the state and the taxing state. In subjecting virtually all of Appellant's Exploration and Production income to apportionment by Wisconsin, the Wisconsin Supreme Court has ignored this nexus requirement. There are no Exploration and Production activities in Wisconsin, so there can be no connection between such activities and the State. Wisconsin tries to ignore this nexus requirement by making a distinction between situs income as part of the unitary stream and situs income that does not enter a unitary stream. This is clearly an attempt in semantics to make a distinction which is not constitutionally defensible. Situs income, *i.e.,* income having no relationship to the taxing state, cannot be divided up into unitary situs income and non-unitary situs income in order to avoid the constitutional requirement, for purposes of state taxation, of some minimal connection between Appellant's Exploration and Production activities and the State.

The Wisconsin Supreme Court acknowledges that the exploration and production of gas and oil is "mining"

within the meaning of Wis. Stats. §71.07(1), and that such activities are situs operations. The relevant provision of §71.07(1) reads as follows:

> "For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived."

§71.07(2) provides, in pertinent part, as follows:

> "In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient • • •."

By the semantics described above the Wisconsin Supreme Court has also attempted to circumvent the mandate of its own statute, which requires all income "derived" from oil and gas exploration and production to be allocated to situs, thereby eliminating it from apportionable income.

Appellant is aware of no decisions of this Court involving the application of an apportionment formula to situs income earned outside the taxing state. The general prohibition set forth in *Hans Rees'* should be controlling to prevent the taxation of such situs income, as it otherwise results in unreasonably and arbitrarily attributing to Wisconsin "a percentage of income all out of appropriate proportion to business transacted by the appellant in that state." (283 U.S. at 135-36).

It should further be emphasized that separate functional accounting, upon which the identification of Appellant's Exploration and Production situs income is established, was clearly authorized and approved by this Court in *Moorman;* and also that separate accounting for Wisconsin operations is available to corroborate the clear conclusion that extraterritorial income is being taxed by the State of Wisconsin. See Point I *supra,* and particularly Schedule A to Exhibit 28, See Appendix I, *infra,* p. App. 86.

In essence what the Wisconsin Supreme Court has done is to make a distinction between "realized" income, *i.e.,* that resulting from sales to third parties, which it concludes is situs income outside of the unitary stream, and "derived" income, *i.e.,* transferred internally at posted field prices, which it considers to be within the unitary stream despite the fact that the Wisconsin statute, §§71.07 (1) and (2), uses only the term "derived" to apply to both situations. Thus, the Wisconsin Supreme Court has written into the statute a distinction which does not exist in the statutory language.

Certainly no such distinction has ever been made by this Court. Indeed, this Court has never recognized that only "realized" income can be used for determining taxable income. On the contrary this Court has used such words as "attributable to" (*Hans Rees'*), "derived" (*Butler Brothers*) and "earned" (*Moorman*) to describe taxable income. In short, the Wisconsin Supreme Court cannot, upon the pretext of dividing situs income between unitary and non-unitary, attempt to avoid the constitutional prohibitions against taxing income that has no reasonable relationship to the taxing state. A repeat of a quote already set forth in Point I, *supra,* is most appropriate to the present situation.

> "But the fact that the corporate enterprise is a unitary one, in the sense that the ultimate gain is derived

from the entire business, does not mean that for the purposes of taxation the activities which are conducted in different jurisdictions are to be regarded as 'component parts of a single unit' so that the entire net income may be taxed in one state regardless of the extent from which it may derive from the conduct of the enterprise in another state." (*Hans Rees', supra,* 283 U.S. at 133).

By creating two categories of situs income out of Appellant's Exploration and Production income, one being taxable and one not, the Wisconsin Supreme Court has rendered §§71.07(1) and (2) unconstitutional under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

III. The Assessment Of Wisconsin Tax On Income Derived From Appellant's Exploration And Production Functional Operations Outside The State From Extraction Of Oil And Gas Not Sold To Third Parties At The Well Head Constitutes A Construction Of Wis. Stats. §§71.07(1) And (2) Which Violates The Commerce Clause Of Article One Of The United States Constitution.

Since 1920 there has been a series of cases which have held that all oil and gas production income was taxable in the producing states. *Shaffer* v. *Carter,* 252 U.S. 37, 40 S.Ct. 221 (1920); *Magnolia Petroleum Co.* v. *Oklahoma Tax Commission,* 190 Okla. 172, 121 P.2d 1008 (1942); *Texas Company* v. *Cooper,* 236 La. 380, 107 So.2d 676 (1959); *Webb Resources* v. *McCoy,* 194 Kan. 758, 401 P.2d 879 (1965). As reflected by these cases, the jurisdiction where the extraction activity occurs has the power to impose an income tax on Appellant's Exploration and Production income. Where other states such as Wisconsin also impose a tax, this results in multiple taxation of that income and constitutes a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution.

The Commission found, based upon the testimony of various witnesses, that the taxation of Appellant's Exploration and Production income by Wisconsin resulted in that income being subjected to multiple taxation. See Appendix C, *infra,* p. App. 66. On Appeal the Circuit Court sustained this finding. See Appendix B, *infra* p. App. 34. The Wisconsin Supreme Court neatly sidestepped this finding by observing that the taxes imposed by the situs states were not imposed on income, thus, in its view, eliminating any question as to multiple taxation or a burden on interstate commerce. The precise language is:

> "The fact that the producing states may impose production taxes which are a form of property tax or severance taxes which have been held to be occupation taxes or property taxes does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income." (footnotes omitted) (90 Wis.2d at 731, 281 N.W.2d at 110-11)

The compelled inferences from the foregoing are that multiple taxation as a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution occurs only (a) if a situs state having the power to tax situs operations actually exercises that power, and (b) if the situs state does exercise its taxing power, the type of tax imposed must be of the same type as that imposed by the non-situs, apportioning state. This utterly ignores the basic propositions that a violation of the Commerce Clause occurs if a state, Wisconsin in this case, imposes a tax on the situs income derived in another state if that other state has the power to impose a tax on such income, regardless of whether or not that power is exercised, or if the situs state chooses to impose a tax determined by its situs operations of a type or variety other than that being imposed by the other taxing state. Thus, by any test, the

Wisconsin Supreme Court in this case chose to ignore the true strictures of multiple taxation as a burden on interstate commerce. This erroneous conclusion of the Wisconsin Supreme Court is further underscored, both in terms of a violation of the Commerce Clause as well as of the Due Process Clause, by its conclusion that Wisconsin is entitled to tax its "fair share" of the total corporate income of a multi-state corporation regardless of the relevancy of the taxation results to the activities carried on by a multi-state corporation within the State of Wisconsin.

In *Moorman,* the taxpayer also claimed that there was a violation of the Commerce Clause in that both Iowa and Illinois imposed a tax of the income derived from Iowa sales. The taxpayer argued that this was brought about by Iowa's use of the single-factor formula and Illinois' use of the more common three factor formula. This Court did not agree that there had been a Commerce Clause violation, stating:

> "Since appellant did not prove the portion derived from sales to Iowa customers, rather than sales to customers in other States, we do not know whether Illinois and Iowa together imposed a tax on more than 100% of the relevant net income." (437 U.S. at 276).

This Court also stressed that:

> "Since the record does not reveal the sources of appellant's profits, its Commerce Clause claim cannot rest on the premise that profits earned in Illinois were included in its Iowa taxable income and therefore the Iowa formula was at fault for whatever overlap may have existed." (437 U.S. at 277).

In the present record before this Court, Appellant has established that the sources of income derived from its Exploration and Production operations were all in states *other* than Wisconsin. Consequently, the Wisconsin apportionment formula clearly includes income from out-of-state sources by encompassing income from Appellant's Exploration and Production operations, and is therefore in violation of the Commerce Clause of the United States Constitution.

Finally, the Wisconsin Supreme Court, by adopting a unitary *per se* approach which subjects to apportionment virtually all of Appellant's total corporate income without regard to any relationship of the activities of Appellant to Wisconsin, causes multiple taxation as an obvious and automatic end result of such a concept, and thereby places a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution.

IV. With The Advent Of The Wisconsin Supreme Court's Decision Herein, A Conflict Has Arisen Between Both The Highest Courts Of Various States And With A Federal Circuit Court Of Appeals In The Treatment Of Exploration And Production Income Of An Oil And Gas Company.

The present decision by the Wisconsin Supreme Court to include a portion of Appellant's Exploration and Production income in the Wisconsin apportionment formula, presents a direct conflict with the decisions of five state supreme courts and one federal court of appeals.

The Minnesota Supreme Court in *Skelly Oil Company* v. *Commissioner of Taxation,* 269 Minn. 351, 131 N.W.2d 632 (1964), concluded that the exploration and production, refining and marketing functions of Skelly were operated as separate businesses. Further, it was concluded that because posted field prices were competitively established, were employed for federal depletion, severance tax, production states' income tax and royalty payment purposes, and were utilized as the prices for which the taxpayer bought

and sold crude oil, they constituted a bona fide base for internal transfer pricing from production to refining. Adding this all together, the Minnesota Supreme Court held that only marketing income was exposed to taxation, this being the only function being carried on in Minnesota, and that the unitary concept was inapplicable. The Court concluded that:

> "Skelly's sole activity in Minnesota is the marketing of finished products, as the proof clearly shows. The only permissible conclusion is that taxes based on the inclusion of production income, no matter what the percentage, in apportionable income are beyond the state's authority. Minnesota may include in the apportionable income subject to its tax only income attributable to Skelly's marketing activity." (131 N.W. 2d at 646).

In *Tenneco, Inc.* v. *Barr,* 224 So. 2d 208 (Miss. 1969), the taxpayer operated a gas transmission system, part of which was situated in Mississippi and a gas exploration and production function carried on outside Mississippi. The former was operated at a profit and the latter at a loss, so the taxpayer sought total apportionment on the unitary theory, which the Mississippi Tax Commission opposed. The Mississippi Supreme Court held the transmission business alone to be unitary and subject to apportionment, but that the gas exploration and production operations were not unitary with or an integral part of the transmission operations, and hence, separate accounting applied to those functions.

The Circuit Court of Appeals of the Eighth Circuit, in *Standard Oil Co.* v. *Thoresen,* 29 F.2d 708 (8th Cir. 1928), held that under the law of North Dakota the plaintiff oil company was *not* required to pay North Dakota taxes on its producing and refining oil business done only in other states simply because it engaged in the business of marketing refined products in North Dakota. The Eighth Circuit was of the opinion that any statute of a state which attempted to tax income from property located in another state was void as being beyond the power of the taxing state.

Furthermore, the supreme courts of three states where there was oil and gas production have held that the income from oil and gas production was allocable to situs and taxable in each respective producing state, regardless of whether or not the taxpayer corporation was unitary or whether the income was actually realized or was derived from a fair market value computation. *Magnolia Petroleum Co.* v. *Oklahoma Tax Commission, supra; Texas Company* v. *Cooper, supra; Webb Resources* v. *McCoy, supra.*

Thus, the decision of the Wisconsin Supreme Court is completely contrary to the decisions in *Skelly, Tenneco, Standard Oil, Magnolia, Texas Company* and *Webb Resources*, and this creates the type of split of authority which this Court should resolve.

CONCLUSION

This case presents in specific focus the factual record on the Due Process Clause challenge which this Court found lacking in *Moorman,* as well as in *Butler Bros.* Thus, it presents this Court with the basis to delineate the limits of constitutionally permissible state apportionment of income from a multi-state taxpayer's activities conducted outside the taxing state. The unitary *per se* result of the Wisconsin Supreme Court's decision presents a question of first impression, and the factual record shows taxation of income out of all appropriate proportion to the activities of the Appellant in Wisconsin with a resulting automatic

burden on interstate commerce. And because this decision stands at complete odds with the decisions of other state supreme courts and of lower federal courts, this appeal also presents this Court with the opportunity of resolving this obvious split of authorities.

For the foregoing reasons it is respectfully requested that probable jurisdiction be noted.

Respectfully submitted,

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APPENDIX

APPENDIX A

No. 76-751

STATE OF WISCONSIN : IN SUPREME COURT
WISCONSIN DEPARTMENT OF REVENUE,
Petitioner-Appellant
and Cross-Respondent,

v.

EXXON CORPORATION,
Respondent
and Cross-Appellant.

(Filed June 29, 1979)

Appeal from a judgment of the circuit court for Dane County: GEORGE R. CURRIE, Reserve Circuit Judge. *AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.*

DAY, J. This is an appeal and a cross-appeal in a corporate income and franchise tax case. The judgment from which this appeal is taken was entered in the circuit court for Dane County, January 31, 1977, the Honorable George R. Currie, presiding. The judgment was the result of a proceeding brought by the Department of Revenue, (hereafter Department) under ch. 227, Stats. to review a decision and order of the Wisconsin Tax Appeals Commission, (hereafter Commission) dated April 6, 1976. The Commission had modified the action of the Department denying Exxon's application for abatement of assessment of additional income and franchise taxes for the years 1965 through 1968. During the years in question, the taxpayer was the Humble Oil Refining Company, a wholly owned subsidiary of Standard Oil Company of New Jersey. In 1973, the parent company changed its name to Exxon Corporation, and Humble was merged into Exxon.

The following questions are presented by this appeal:

1. Were the taxpayer's Wisconsin operations an integral part of a unitary business within the meaning of sec. 71.07(2), Stats. (1967)?

2. Does the exclusion from taxation of situs income under the provisions of secs. 71.07(1) and (2), Stats., (1967) apply to all income derived from the production of crude oil and natural gas, or only to that income derived from sales to third parties at or near the well-head?

3. In applying the statutory apportionment formula of sec. 71.07(2), Stats., (1967), did the Department properly weight the cost of manufacturing factor by employing a divisor of 2.6, instead of 3?

We hold that the taxpayer's Wisconsin operations constituted an integral part of a unitary business, subject to statutory apportionment of its income. We also uphold the Department's interpretation of the situs income exclusion to apply only to income derived from sales to third parties at or near the well-head. Finally, for reasons discussed below, we remand the question of the weighting of the apportionment formula to the Commission for further proceedings.

The taxpayer is a corporation organized under the laws of Delaware, with its general offices located in Houston, Texas. This case deals only with the years 1965 through 1968. During that time, Humble Oil and Refining Company was a wholly owned subsidiary of Standard Oil Company of New Jersey. In 1956, Standard Oil of New Jersey organized a wholly owned Delaware subsidiary which then acquired all of the assets and liabilities of Saxon Corporation, a Wisconsin corporation formerly named Pate Oil Company. The new subsidiary continued the operations of the former Wisconsin company, under the name of

Pate Oil Company, which consisted of marketing petroleum products and accessories in Wisconsin. Corporate income tax reporting to the State of Wisconsin was done on the basis of separate accounting which reflected only the Wisconsin marketing operations. In 1960, Standard Oil of New Jersey caused the new Pate Oil Company to be merged into Humble Oil Refining Company, and Humble continued the Wisconsin marketing operations under the brand name of Enco. In 1973, Humble was merged into Standard Oil of New Jersey, and the parent company's name was changed to Exxon. Exxon is the legal successor to Humble.

Humble timely filed its Wisconsin corporation income and franchise tax returns for the calendar tax years 1965 through 1968, using the separate accounting method. The returns showed losses in the amounts of $821,320; $1,159,830; $1,026,224; and $919,575, respectively for the years 1965, 1966, 1967 and 1968. No tax was shown as being due for those years.

The Department audited Humble for the tax years 1965 through 1968, and on June 25, 1971, the Department forwarded to Humble notice of assessment of additional income and franchise tax. The notice was appended to the Department's audit report, in which the auditor stated that Humble's income was subject to apportionment, thus subjecting it to tax on additional income of $4,532,155 for the period 1965 through 1968. Additional taxes in the amount of $316,470.85 were assessed against Humble.

Humble filed an application for abatement of the assessment, which was denied by the Department. Proceedings were held before the Wisconsin Tax Appeals Commission, which modified the Department's action of Humble's application for abatement by a decision and order dated April 8, 1976. The Commission found that Humble's three main

functional operating departments—exploration and production, marketing, and refining—were each unitary businesses. The Commission decided that the Department had properly refused to permit Humble to report its income by the separate accounting method, that for the years in dispute, Humble was operating a multi-state unitary marketing business within the meaning of sec. 71.07(2), Stats., and that Humble's Wisconsin marketing operation was an integral part of that marketing business. However, the Commission also found that Humble's Wisconsin marketing operations were not an integral part of either Humble's exploration and production function or refining function, and that there was no economic dependence between Humble's Wisconsin marketing operations and the exploration and production and refining functions. Thus, the Commission concluded that the Department could not use the statutory apportionment formula to reach income from Humble's refining and exploration and production departments.

On review under ch. 227, the Circuit Court for Dane County set aside some of the findings of the Commission. Judge Currie, in his opinion, stated that the following findings of fact were actually erroneous conclusions of law and set them aside:

> "19. The petitioner's three main functional operating departments, exploration and production, marketing, and refining, were each unitary businesses.
>
> "21. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its exploration and production function.
>
> "23. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its refining function."

The trial court also set aside the following conclusions of law made by the Commission:

> "3. During the years in issue, the petitioner was operating a multistate unitary marketing business within the intent and meaning of Section 71.07(2) of the Wisconsin Statutes, and the petitioner's Wisconsin marketing operation was an integral part thereof.
>
> "6. The apportionment formula used by the respondent in the audit and assessment here under review was improper in including income from petitioner's exploration, production and refining departments, and resulted in assessing a tax on extraterritorial income earned by the petitioner.
>
> "7. An apportionment formula, apportioning income earned by the petitioner from its marketing function within and without the State of Wisconsin, would be proper and within the intent and meaning of the statutory mandate contained in Section 71.07(2) of the Wisconsin Statutes."

However, the trial court also held that the Department's interpretation of the situs exclusions of secs. 71.07(1) and (2) to exclude from taxation only Humble's income from crude oil and gas sold to third persons at the situs of origin, thus subjecting the remainder of situs income to taxation through application of the apportionment formula would be unfair and violative of the intent of sec. 71.07. The trial court also approved the Department's weighting of the costs of manufacturing aspect of the apportionment formula to provide for a divisor of 2.6, instead of 3, as prescribed in the statute.

The Department appeals only from that portion of the judgment which determined that the Department must exclude all situs income derived from the production of crude oil and gas, whether or not sold to third parties. Exxon appeals from those aspects of the judgment which deter-

mined that Humble's total business within and without Wisconsin constituted a unitary business, and which permitted the Department to weight the costs of manufacturing component of the apportionment formula.

QUESTION #1: WERE THE TAXPAYER'S WISCONSIN OPERATIONS AN INTEGRAL PART OF A UNITARY BUSINESS WITHIN THE MEANING OF SEC. 71.07(2), STATS. (1967)?

This case brings into play several sections of ch. 71, Stats., (1967):

"71.01. *Imposition Of Tax; Exempt Income.* . . . (2) *Franchise Tax On Corporations.* For the privilege of exercising its franchise or doing business in this state in a corporate capacity every domestic or foreign corporation, except corporations specified in sub. (3), shall annually pay a franchise tax according to or measured by its entire net income of the preceding income year at the rates set forth in s. 71.09 (2 am). Every corporation organized under the laws of this state shall be deemed to be residing within this state for the purposes of this franchise tax. All provisions of chs. 71 and 73 relating to net income taxation of corporations shall apply to franchise taxes imposed under this subsection, unless the context requires otherwise. The tax imposed by this subjection on national banking associations shall be in lieu of all taxes imposed by this state on national banking associations to the extent it is not permissible to tax such associations under federal law."

"71.07. *Situs Of Income; Allocation And Apportionment.* (1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm,

mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived. Corporation income from personal services performed by employes of corporations shall be deemed business income and shall follow the situs of the business. Income from personal services and from professions of resident individuals shall follow residence. Income from personal services of nonresident individuals, including income from professions, shall follow the situs of the services. All other income or loss, including royalties from patents; income or loss derived from land contracts, mortgages, stocks, bonds and securities or from the sale of similar intangible personal property, shall follow the residence of the recipient, except as provided in s. 71.07(7). For the purposes of taxation, interest received on state and federal tax refunds when the tax refunded was on business income or property shall be deemed income from business and shall follow the situs of the business from which derived.

"(2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient; provided, that in the case of income which follows the residence of the recipient, the amount of interest and

> dividends deductible under this provision shall be limited to the total interest and dividends received which are in excess of the total interest (or related expenses, if any) paid and allowable as a deduction under section 71.04 during the income year. The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios: . . ."

The purpose of these sections is to determine what portion of a taxpayer's income is attributable to activities in the state of Wisconsin, since the opening sentence of sec. 71.07(2) states: "Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state."

The two methods—separate accounting and formula apportionment—were described in Keesling and Warren, *The Unitary Concept,* 12 Hastings Law Journal 42, 43 (1960) as follows:

> "In the apportionment of business income two methods have been devised which have come to be known as the 'separate accounting' method and the 'formula' method, respectively. Under the separate accounting method, as the name implies, the business within the state is treated separately and distinctly from the business outside the state and the income is computed in much the same manner as it would be if the taxpayers' activities were confined solely to the taxing state. The gross income from the business activities within the state is first determined. The allowable deductions are then subtracted. The remaining net income is attributed in its entirety to the taxing state.
>
> "Under the formula method the business activities within the state are considered to be an inseparable part of a business carried on both within and without the state. The total gross income from the entire business is determined. The allowable deductions are then subtracted and the remaining net income is apportioned within and without the state by means of an allocation formula consisting of various factors which are thought to be relevant in the production of income, such as property, payroll, and sales."

The term "unitary" has been variously defined. The definition applied in *Interstate Finance Corp.* v. *Dept. of Taxation,* 28 Wis. 2d 262, 269, 137 N.W. 2d 38 (1965), and relied on by the trial court in the instant case, borrows from the text authority Altman & Keesling, *Allocation Of Income In State Taxation,* (2d ed.), p. 101:

> ". . . the essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. If there is such a relationship the business is unitary."

This is the definition to which we continue to adhere.

Sec. 71.07(2), Stats., (1967) requires that the apportionment method be used by a taxpayer engaged in business within and without the state when the taxpayer's Wisconsin business is an integral part of a unitary business. *Celon Co.* v. *Dept. of Taxation,* 269 Wis. 372, 377-78, 69 N.W. 2d 453 (1955). The statute sets forth ratios for the apportionment method but gives the department considerable latitude in adopting a formula which will most accurately reflect a reasonable and equitable tax on the income earned in Wisconsin. *Interstate Finance Corp., supra* at 271-272. This court has held that the latitude of the statute itself is not unconstitutional as arbitrary or unreasonable or taxing extraterritorial income, although the application of the statute in some instances might be. *Id.* at 272.

The trial court below characterized some of the findings of the Tax Appeals Commission as erroneous conclusions of law, rather than findings of fact. Those findings were: 1) that Humble's three main functional operating departments—exploration and production, marketing, and refining—were each unitary businesses; 2) that there was no economic dependence between Humble's Wisconsin marketing operations and the exploration and production function, and 3) that there was no economic dependence between Humble's marketing operations and the refining function.

Judge Currie, when a Wisconsin Supreme Court Justice wrote the opinion of this Court in *Pabst* v. *Dept. of Taxation*, 19 Wis. 2d 313, 120 N.W. 2d 77 (1963), wherein this Court pointed out that courts use two conflicting methods of administrative review where the issue is whether the administrative agency has correctly applied a statute to certain facts.

> "The first is the so-called analytical approach whereby the court decides which part of the agency's determination presents a question of fact and which part a question of law. The second is the practical or policy approach which tries to avoid allocation of functions merely on the literal meaning of the terms 'fact' and 'law.' When this practical approach is used, the court holds that, 'The judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body.' On the other hand, Davis notes that when the court deems the question presented to be suitable for judicial determination, it feels free to substitute its own judgment for that of the agency. When the court substitutes its own judgment, however, it would appear that it in effect finds the agency's decision without rational basis in law or treats the issue analytically as a question of law for the court." *Id.* at 322-23.

While this court has held that ch. 227, Stats. requires that courts employ the "analytical" approach when reviewing agency decisions, this court will give deference to agency determinations, where the agency has particular expertise, rational basis exists in law for the agency's interpretation, and it does not conflict with the statute's legislative history, prior decisions of this court, or constitutional prohibitions. *Id.* at 323-24.

When mixed questions of law and fact are presented to this court, there are really two component questions which must be answered. The first question is what, in fact, actually happened; the second question is whether those facts, as a matter of law, have meaning as a particular legal concept. Comment, *The Scope Of Judicial Review Of Administrative Agency Decisions In Wisconsin*, 1973 Wis. L. Rev. 554 (1973). The question of whether the facts fulfill a particular legal standard is itself a question of law. See *Cheese* v. *Industrial Comm.*, 21 Wis. 2d 8, 15, 123 N.W. 2d 553 (1963).

Thus, for example, in *Cheese, supra,* the court substituted its judgment for that of the Industrial Commission on whether particular conduct by the claimant constituted "misconduct connected with his employment." In *Pabst, supra,* the court concluded that the question of whether a trust was administered in Wisconsin was a question of law. In *Globe-Union, Inc.* v. *Dept. of Taxation,* 20 Wis. 2d 213, 219, 121 N.W. 2d 894 (1963), the court treated as a question of law, whether various sales had been made in Wisconsin for purposes of corporate income tax apportionment.

This court accepts the view of the circuit court in this case that the question of whether Humble constituted a unitary operation is a question of law. The manner in which Humble conducted its business requires a series of fac-

tual determinations; the legal significance of those business arrangements is a judicial question subject to review by this court. Further, in its findings, the Tax Appeals Commission only stated that there was no economic dependence between the Wisconsin marketing operations and the refining and exploration and production functions of Humble. The full test requires a determination of whether the operation of the portion of the business is "dependent upon *or contributory to* the operation of the business outside the state." *Interstate Finance Corp., supra,* 28 Wis. 2d at 269. (emphasis added).

For the years in question, Humble's corporate organization consisted of three parts: corporate management, coordination and services management, and operations management. Corporation management was the highest level of management in the company. In this review, the court is concerned only with operations management which was responsible for directing the operating activities of the individual functional segments of the company. Each functional segment was organized into a separate department which operated independently of the other operating segments. The individual functional segments under Operations Management consisted of Exploration and Production, Refining, Marketing, Marine, Coal and Shale Oil, Minerals, Land Management. Exploration and Production was further broken down into exploration, production, and natural gas. The three major departments were Exploration and Production, Refining, and Marketing.

Each operating department had its own separate management responsible for the proper conduct of the operation. Each had a separate profit center which provided a means for recording transactions involving expense and revenue so that a profit for each function could be determined. Each department was considered a separate investment center by the company.

It was the management philosophy of Humble to have each department independently responsible for its performance in order to measure the performance of each department. Under this system, each department is in competition with the other departments for available funds for investment. Each functional department was also in competition with other members of the industry operating the same function.

There was no requirement that crude oil produced by the Production department flow through the marketing outlets in the form of Humble refined products. The company had extensive dealings with third parties for the acquisition of raw materials and products sold.

It was company policy that the transfer of products and raw materials between departments be based on competitive wholesale market prices. Thus, crude oil produced and transferred to the refining department was accounted for at posted industry prices. As a result the refining department paid the same price for Humble-produced crude as it would pay for crude oil from any other supplier. Products transferred from the refining department to the marketing department were also based on wholesale market prices or some alternate value. Where there was no readily available wholesale market value for a product, Oral Luper, an Exxon senior vice president testified that "the representatives of our Marketing Department and our Refinery Department with both of their knowledge of the market, knowledge of the products, negotiate with each other on an arm's length basis in an adversary position to try to negotiate the appropriate transfer value to the best of their ability, market orientated."

Significantly, Luper also testified as to the reasons for organizing the separate operating departments under one corporate entity.

> ". . . [I]n any industry which is highly capital intensive, such as the petroleum industry, the fixed operating costs are highly relative to total operating costs, and for this reason the profitability of such an industry is very sensitive and directly related to the full utilization of the capacity of the facilities.
>
> "So, in the case of the petroleum industry . . . where you have high capital investments in refineries, the existence of an assured supply of raw materials and crude is important and the assured and stable outlet for products is important and therefore when there are—when these segments are under a single corporate entity, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time."

Luper also stated that putting the individual operating segments under one corporate entity provided greater profit stability for the company, spread risks, and enabled corporate staff to provide services on a corporate-wide basis more efficiently and effectively. The existence of a stable and assured market outlet is directly related to the refining investment. Luper testified that as an officer of the company, he is concerned directly with the overall profits of the entire company. The profits of each of the individual functional segments go into a determination of the overall corporate profits.

Humble has a uniform credit card system used nationwide which is a valuable marketing tool. It is administered centrally in Houston, Texas, with accounting and collection carried out at two or three credit card centers. Humble promotes its products by uniform packaging and brand

names. The overall plan for distribution of products is developed in Houston. Promotional display equipment is designed by the engineering staff at headquarters marketing. Key employees of the Company are transferred from one department to another frequently.

The factors determining whether Humble produced crude oil will be sold to third parties or transferred to the Humble refinery include the distance from the point of production to the refinery and the quality of the crude. Once Humble-produced crude enters the pipeline system, it moves to the most desirable market, and in some cases, that is to a Humble refinery. There is no way of identifying the origin of the crude oil after it has entered the pipeline.

It is undisputed that Humble carried on no production or refining functions in Wisconsin. The only activities in the state related to marketing of the product. The gasoline and fuel oil sold in Wisconsin by Humble did not originate in Humble's oil wells. They came into the state as a result of an exchange agreement Humble had with Pure Oil Company at Lemont, Illinois. The products exchange portion of the agreement was set up at a time when Humble was expanding in the Midwest market. Pure Oil had more refining capacity than marketing requirements in the Midwest and wanted to find a way to get products to the East coast. The major purpose of any exchange agreement of this type is to reduce the cost of transporting the product from the source of production to the point where it is sold. The exchange contracted was negotiated by Humble's Supply and Refining Departments.

The gasoline received by Humble in the exchange is either refined according to Humble's specifications or meets certain basic criteria before it is accepted by Humble for exchange. For Humble-refined gasoline, additives

developed by Humble are mixed into the gasoline at the refinery. For gasoline acquired through exchange, the Humble additives are injected into the gasoline at the point of exchange. Seasonal variations in weather must be taken into account so that a different gasoline is manufactured for winter than is manufactured for summer. Quality control starts at the time of refining and continues through transportation to insure that the quality of gasoline delivered at the service station is the same as that produced at the refinery.

Motor oils, greases, and other packaged products were produced and manufactured by Humble outside of Wisconsin and shipped into the state for sale from Humble's central warehouse facilities in Chicago, Illinois, and other out-of-state locations. Tires, batteries and accessories were centrally purchased by Humble's purchasing office in Houston, Texas and shipped from out-of-state locations into Wisconsin for sale.

What emerges from this pattern of organization is that Humble's production and refining functions depended upon the marketing operation to provide an outlet for its products. Wisconsin was a part of Humble's marketing system. In a high capital investment industry such as the petroleum industry, the existence of a stable and assured marketing system is important for the full utilization of refining capacity. This was the testimony of a top Exxon executive who admitted that the profits of the overall corporation depend on the profits of each of the individual functional segments.

The United States Supreme Court has held that the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the

realization of profits. *Butler Brothers* v. *McColgan*, 315 U.S. 501, 508 (1942); *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123, 133 (1931).

The Oregon Tax Court, in a case dealing with the identical taxpayer, faced a factual pattern virtually indistinguishable from the one before this court. Humble's operations in Oregon were almost exclusively concerned with marketing. It had no manufacturing or refining facilities in Oregon, nor any sale of crude oil or natural gas. Although it was engaged in exploration for crude oil in Oregon during the years in question, there was no production. All of the refined petroleum products and related automotive accessories sold in Humble's service stations in Oregon were acquired by purchase from third party suppliers, except for oils and greases which were supplied centrally by Humble from its plants and refineries throughout the United States. These centrally supplied items amounted to about five percent in value of the total products marketed in Oregon. Humble's books, maintained on a separate accounting basis, showed a net operating loss for the Oregon operations.

The Oregon Tax Court determined that Humble was a unitary business and that the apportionment method of accounting was proper because it most fairly and accurately reflected the net income of the taxpayer attributable to Oregon. The court also made the following comments:

> "Humble Oil & Refining Company is a large vertically integrated corporation engaged nationwide in all phases of the petroleum industry, from discovery through production and manufacture to marketing. It has unity of ownership, operations, management, control and products; and strong centralized credit, purchasing, advertising, accounting and legal services. All segments of plaintiff's business have a great deal in common and contribute to and are dependent upon

each other. The plaintiff is actually a single interrelated unitary business operation. The component parts, including those in Oregon, are too closely connected and necessary to each other to be considered as independent units.

"Producing in one state and selling in another depends upon a multitude of interdependent operations, and although the petroleum Humble sold in Oregon was not its own production but that of a third party, the sales nevertheless were made possible by the company's own production. If plaintiff wasn't producing it wouldn't be selling, and what plaintiff did in Oregon was not due solely to conditions here, but was dependent upon the market elsewhere and upon plaintiff's production and manufacturing elsewhere. The marketing in Oregon was an integrated part of plaintiff's nationwide business and undoubtedly was beneficial to the corporation as a whole. It was not a completely separate, independent or local endeavor. Plaintiff's production and refining conform to the demands of the nationwide market, and the court believes plaintiff expanded into Oregon to increase demand for its products so that it could increase production and refining and thus increase profits and its stature in the industry.

There certainly was more to plaintiff's decision to operate service stations in Oregon than the mere hope the stations might show a profit. The purpose of marketing here was to increase over-all marketing strength for the benefit of all phases of plaintiff's business. Costs incurred here led to profits elsewhere, and the primary measure of success of Oregon activities was not the profit or loss shown on the income statements of the local service stations, but rather it was the contribution the stations made to plaintiff's over-all operations and growth that really counted. The plaintiff bought its Oregon inventory of gasoline from third parties because it was more economical to do so, and whether an outlet sold Humble production or that of

another company was a central management decision based on over-all economic considerations. Each activity of the company was carried on in whatever locality was most economically feasible. Plaintiff was so organized and vertically integrated that its separate parts, geographical and structural, could not be fairly considered by themselves." *Humble Oil & Refining Company* v. *Dept. of Revenue,* 4 OTR 284, 292-93 (1971).

That Humble reported losses for its Wisconsin operations for the disputed years is immaterial. The same question was addressed in *Butler Brothers* v. *McColgan, supra.* In that case, Butler Brothers was a wholesale merchandising company whose home office was in Illinois, and which had branches in seven different states. It attempted to show that its California branch operated at a $70,000 loss as reflected in a separate accounting return, and that an income tax calculated on an apportionment basis was unconstitutional because it taxed extraterritorial values. The Supreme Court commented:

"It is true that appellant's separate accounting system for its San Francisco branch attributed no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore, A Statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. Cf. Hamilton, Cost as a Standard for Price, 4 Law & Contemporary Problems 321. That may be due to the fact, as stated by Mr. Justice Brandeis in *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113, 121, that a State in at-

tempting to place upon a business extending into several States 'its fair share of the burden of taxation' is 'faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.' Furthermore, the particular system used may not reveal the facts basic to the State's determination. *Bass, Ratcliff & Gretton, Ltd.* v. *Tax Commission, supra,* p. 283. In either aspect of the matter, the results of the accounting system employed by appellant do not impeach the validity or propriety of the formula which California has applied here." 315 U.S. at 507-508.

We hold that the taxpayer's Wisconsin operations were an integral part of a unitary business within the meaning of sec. 71.07(2), Stats., (1967). Thus, its income was subject to apportionment under the statutory formula. The constitutionality of this apportionment will be discussed below together with our consideration of the situs income exclusion.

QUESTION #2: DOES THE EXCLUSION FROM TAXATION OF SITUS INCOME UNDER THE PROVISIONS OF SEC. 71.07(1) AND (2), STATS., (1967), APPLY TO ALL INCOME DERIVED FROM THE PRODUCTION OF CRUDE OIL AND NATURAL GAS, OR ONLY TO THAT INCOME DERIVED FROM SALES TO THIRD PARTIES AT OR NEAR THE WELL-HEAD?

The pertinent portions of sec. 71.07 are:

"71.07. *Situs Of Income; Allocation And Apportionment.* (1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property

or tangible personal property shall follow the situs of the property from which derived. . . .

"(2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient; . . ."

The parties agree that extraction and production of gas and oil is "mining" within the meaning of sec. 71.07(1), Stats., *supra.* Gas and oil operations were held to be situs operations by the Tax Appeals Commission in *Leonard R. Jevne* v. *Dept. of Revenue,* Docket No. I-4956, April 14, 1976 CCH par. 12-402.577; *Deane A. Neitzel* v. *Wisconsin Dept. of Revenue,* Docket No. I-4872, November 17, 1975, CCH par. 12-402.577 and we concur in that view.

It is the position of the Department of Revenue that the situs income exclusion applies only to income realized from sales of crude oil and gas to third parties. The Department does not recognize as excludable situs income the value of crude oil and gas transferred by Humble from its production to refinery operations. There was testimony that such transfers took place at "posted field prices," which are considered to be bona fide third party prices.

Sec. 71.07, Stats. (1967) divides the income of a taxpayer operating both within and without Wisconsin into "apportionable income" and "nonapportionable income." Apportionable income is that income which for income tax purposes must be allocated to two or more states in which the taxpayer's business is carried on. Non-apportionable income is that income which follows the situs of the property or the residence of the taxpayer and, as a result, is not allocated among two or more states. *Transamerica Financial Corp.* v. *Dept, of Revenue,* 56 Wis. 2d 57, 65-66, 201 N.W. 2d 552 (1972).

However, the statute contains an ambiguity since sec. 71.07(1), reads:

> ". . . For the purpose of taxation income or loss from business, *not requiring apportionment* under sub. (2), (3) or (5), shall follow the situs of the business from which derived. . . ." (Emphasis added).

Since Exxon is unitary, apportionment of its business income *is* required. This reading of the statute supports the department's interpretation that situs income which is part of the unitary stream of income is apportionable, while situs income which does not enter the unitary stream is nonapportionable, and therefore excludable. If situs income could not be apportioned, there would have been no reason to include the words "not requiring apportionment. . . ." in the subsection dealing with situs income.

The holding of *Transamerica Financial Corp., supra,* which construed the meaning of the interest and dividends deduction of sec. 71.07 is inapposite. There, the court said an administrative construction by the department would not be given force where inconsistent with an unambiguous statutory provision. Here the statute is ambiguous, and subject to interpretation.

The question remains whether the state's effort to reach income from the taxpayer's refining and exploration and

production departments comports with the constitutional requirements of the Due Process and Commerce Clauses.

If a state tax " 'is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State,' no impermissible burden on interstate commerce will be found, *Complete Auto Transit Inc.* v. *Brady,* 430 U.S. 274, 279 (1977); *Washington Revenue Dept.,* 435 U.S. at 750." *Japan Line, Ltd.* v. *County of Los Angeles,* ..... U.S. ..... [47 U.S.L.W. 4477 (April 30, 1979)].

Recently, the United States Supreme Court upheld the constitutionality of Iowa's single factor apportionment formula. *Moorman Mfg. Co.* v. *Bair,* 437 U.S. 267 (1978). In that case, Moorman Manufacturing was an Illinois corporation engaged in the manufacture and sale of animal feeds. The products sold to Iowa customers were manufactured in Illinois, but the company had over 500 salesmen in Iowa and owned six warehouses in the state from which deliveries were made to Iowa customers.

Moorman's Due Process argument rested on two premises—first, that its Illinois operations were responsible for some of the profits generated by sales in Iowa, and second, that a formula that reaches any income not in fact earned within the borders of the taxing state violates due process.

On the first argument, the Court said that Moorman had failed to make out a factual case:

> "Appellant does not suggest that it has shown that a significant portion of the income attributed to Iowa in fact was generated by its Illinois operations; the record does not contain any separate accounting analysis showing what portion of appellant's profits was attributable to sales, to manufacturing, or to any other phase of

the company's operations. But appellant contends that we should proceed on the assumption that at least some portion of the income from Iowa sales was generated by Illinois activities." 437 U.S. at 272.

Exxon maintains that this language entitles it to succeed since by separate functional accounting, it has shown the income for all three of its functional operations. In Exhibit twenty-eight, Humble set forth a comparison between the Wisconsin results yielded by separate accounting, and those yielded by apportionment of the marketing function alone, the marketing and refining functions, as well as alternative treatment of situs income from the exploration and production department.[1] Exxon argues that it has proven by functional accounting that extraterritorial income was included in the Wisconsin apportionment formula, since Humble's exploration and production income was all earned from activities outside of Wisconsin.

Initially, we point out that the implication in the language upon which Exxon relies is merely *dicta*. More importantly, the idea of separate functional accounting seems to be incompatible with the

> "very essence of formulary apportionment, namely, that where there are integrated, interdependent steps in the economic process carried on by a business enterprise, there is no logical or viable method for accurately separating out the profit attributable to one step in the economic process from other steps. It is for that reason that the States have resorted to formulary apportionment—unrefined and approximate though the results may be—in the case of an enterprise engaged in manufacturing and selling, where the activities take place in more than one State. Essentially, the same inherent difficulties are present in seeking to divide the profits of an oil company, where producing, manufacturing and marketing take place in different States." Hellerstein, *State And Local Taxation*, (3rd Edition, 1969), p. 400.

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[1] Footnote 1 on following page.

[1] Abstracted from Exhibit 28:

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Summary of Alternative Methods of Attributing Income to Wisconsin

Schedule A -- 1965-1968
Page 1 Of 1

Year	State's Hybrid Apportionment		Humble's Wisconsin Separate Accounting		Marketing Function Apportioned Only		Marketing & Refining Apportioned Only		Exploration And Production Separate Business or Allocation to Situs	
	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax
1965	$ 759,371	$ 52,961	($ 821,320)	$ -0-	$ 541,794	$ 37,731	$ 282,383	$ 19,572	$ 310,841	$ 21,564
1966	1,043,395	72,843	(1,159,830)	-0-	316,081	21,931	430,866	29,967	443,520	30,851
1967	1,264,946	88,351	(1,026,224)	-0-	394,993	27,455	490,252	34,123	503,182	35,028
1968	1,464,443	102,316	(919,575)	-0-	833,739	58,167	655,869	45,716	700,086	48,811
Totals	$4,532,155	$316,471	($3,926,949)	$ -0-	$2,086,607	$145,284	$1,859,390	$129,378	$1,957,629	$136,254
	(From Audit Report)		(From Wisconsin Returns)		(From Schedule D)		(From Schedule E)		(From Schedule C)	
Differences With State Audit And:										
a) Separate Accounting			$2,459,104	$316,471						
b) Marketing Apportioned Only					$2,445,548	$171,187				
c) Marketing And Refining Apportioned Only							$2,672,765	$187,093		
d) Exploration And Production As Separate Business Or Allocation To Situs									$2,574,526	$180,217

NOTE: This schedule summarizes the resulting Wisconsin net taxable income and franchise tax liability under four alternative conclusions as to the method for arriving at the net income attributable to Humble's activities in Wisconsin during the years 1965 thru 1968.

1) Separate accounting for Wisconsin marketing activities, as reported in Humble's Wisconsin tax returns.
2) Marketing functional department's net income allocated and apportioned to Wisconsin under the statutory formula, and all other income treated as from separate out-of-state businesses.
3) Marketing and Refining functional departments' combined net income allocated and apportioned to Wisconsin under the statutory formula; and all other income treated as from separate out-of-state businesses.
4) Exploration and Production function's net income treated as (a) a separate out-of-state business, or (b) as income from "mining" allocated to situs, with all other non-allocable net income of Humble apportioned under the statutory three-factor formula.

Rather, the question is whether the state's grasp remains within the limits of constitutional mandates. This is borne out by the further comments of the court in *Moorman*, 437 U.S. at 272-274:

> "Yet even were we to assume that the Illinois activities made some contribution to the profitability of the Iowa sales, appellant's claim that the Constitution invalidates an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing State is incorrect.
>
> "The Due Process Clause places two restrictions on a State's power to tax income generated by the activities of an interstate business. First, no tax may be imposed, unless there is some minimal connection between those activities and the taxing State. *National Bellas Hess, Inc.* v. *Dept. of Revenue*, 386 U.S. 753, 756, 87 S.Ct. 1389, 1390, 18 L.Ed. 2d 505. This requirement was plainly satisfied here. Second, the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing state.' *Norfolk & Western R. Co.* v. *Missouri*, 390 U.S. 317, 325, 88 S.Ct. 995, 1001, 19 L.Ed. 2d 1201.
>
> "Since 1934 Iowa has used the formula method of computing taxable income. This method, unlike separate accounting, does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State. The single-factor formula used by Iowa, therefore, generally will not produce a figure that represents the actual profits earned within the State. But the same is true of the Illinois three-factor formula. Both will occasionally over-reflect or under-reflect income attributable to the taxing State. Yet despite this imprecision, the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula. . . .

> "In individual cases, it is true, the Court has found that the application of a single-factor formula to a particular taxpayer violated due process. See *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123, 51 S. Ct. 385, 75 L.Ed. 879; *Norfolk & Western R. Co.* v. *State Tax Comm.*, 390 U.S. 317, 88 S. Ct. 995, 19 L.Ed. 2d 1201. In *Hans Rees'*, for example, the Court concluded that proof that the formula produced a tax on 83% of the taxpayer's income when only 17% of that income actually had its source in the State would suffice to invalidate the assessment under the Due Process Clause. But in neither *Hans Rees'* nor *Norfolk & Western* did the Court depart from the basic principles that the States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted . . . in that State,' 283 U.S., at 135, 51 S. Ct., at 389, or has 'led to a grossly distorted result,' 390 U.S. at 326, 88 S. Ct. at 1002.'' 98 S. Ct. at 2344-2345.''

Exxon also argues that the Wisconsin apportionment formula violates the Commerce Clause since the sources of income derived from the exploration and production function were all in states other than Wisconsin.

However, the court in *Moorman* stated:

> . . . "Since there is no evidence in the record regarding the percentages of its total net income taxed in the other States in which it did business during those years, any claim that appellant was taxed on more than 100% of its total net income would also be speculative.'' 437 U.S. at 276, fn. 11.

Such evidence is also absent from the record in the instant case.

Using the figures from Exhibit thirty-five,[2] Wisconsin sales for the four years represented .41 percent of total

2. Exhibit 35:

HUMBLE OIL & REFINING COMPANY

1965–1968 Wisconsin Corporation Franchise Tax Audit
Comparison Of Net Income Of Total Company With Assessed Income From Wisconsin Operations

Year	(1) Wisconsin Sales	(2) Wisconsin Assessed Taxable Income	Net Income Percentage Of Sales	(3) Total Company Sales	(4) Total Company Net Income Wisconsin Basis	Net Income Percentage Of Sales
1965	$12,980,144	$ 759,371	5.9%	$ 3,462,675,348	$ 403,594,652	11.6%
1966	14,358,059	1,043,395	7.3%	3,480,707,694	468,647,833	13.5%
1967	16,350,330	1,264,946	7.7%	3,720,832,181	541,954,615	14.6%
1968	16,384,760	1,464,443	8.9%	3,984,479,455	608,009,771	15.3%
Totals	$60,073,293	$4,532,155	7.5%	$14,648,694,678	$2,022,206,871	13.8%

Notes:
1) From State Audit, Page 12 (Exhibit E-3) EXHIBIT # _____
2) From State Audit, Page 1 (Exhibit A-B) EXHIBIT # _____
3) See Computation Below
4) From State Audit, Page 2 (Exhibit C) EXHIBIT # _____

*3	1965	1966	1967	1968
Total Company Sales	$4,070,986,858	$4,095,866,931	$4,402,573,496	$4,708,312,[illegible]6
Adjustments				
1. Taxes on Products Sold	(604,793,382)	(611,275,049)	(677,457,213)	(719,189,807)
2. Cash Discounts	(3,518,128)	(3,884,188)	(4,284,102)	(4,643,126)
Total Adjusted Sales	$3,462,675,348	$3,480,707,694	$3,720,832,181	$3,984,479,455

* From State Audit, Page 12 (Exhibit E-3) EXHIBIT # _____

company sales ($60,073,293) divided by $14,648,694,678). Wisconsin assessed taxable income for the four years represented .22 percent of total company net income adjusted to a Wisconsin basis ($4,532,155 divided by $2,022,206,871). Wisconsin can hardly be accused of reaching out for more than its fair share of the taxpayer's income.

The taxpayer's activities have a "substantial nexus" with the state, as demonstrated by Wisconsin sales of $60,073,293 for the four year period of refined petroleum products and automotive accessories. As discussed above, the tax is fairly apportioned to represent only that part of the taxpayer's income which can be attributed to its Wisconsin activities. There has been no claim that the tax discriminates between interstate and intrastate commerce. Finally, the tax is "fairly related to services provided by the State." As the Supreme Court noted in *Japan Line, Ltd., supra* at 4480, such benefits "include not only police and fire protection, but the benefits of a trained work force and the advantages of a civilized society."

The fact that the producing states may impose production taxes which are a form of property tax[3] or severance taxes which have been held to be occupation taxes or property taxes[4] does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income. As the Supreme Court stated in *Western Live Stock* v. *Bureau of Revenue,* 303 U.S. 250, 254 (1938):

[3] Sullivan, *Handbook Of Oil & Gas Law,* (Prentice-Hall, Inc. 1955) p. 490.

[4] Summers, *Oil & Gas,* (Vernon Law Book Company, 1962) §801, p. 409.

"It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business, 'Even interstate commerce must pay its way.' "

QUESTION #3: IN APPLYING THE STATUTORY APPORTIONMENT FORMULA OF SEC. 71.07(2), STATS., (1967), DID THE DEPARTMENT PROPERLY WEIGHT THE COST OF MANUFACTURING FACTOR BY EMPLOYING A DIVISOR OF 2.6 INSTEAD OF 3?

Sec. 71.07(2), Stats., provides that after nonapportionable income is subtracted,

"The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios:

"(a) The ratio of the tangible property, real, personal and mixed, owned and used by the taxpayer in Wisconsin in connection with his trade or business during the income year to the total of such property of the taxpayer owned and used by him in connection with his trade or business everywhere. Cash on hand or in the bank, shares of stock, notes, bonds, accounts receivable, or other evidence of indebtedness, special privileges, franchises, good will, or property the income of which is not taxable or is separately allocated, shall not be considered tangible property nor included in the apportionment. In determining apportionable net income with respect to the calendar year 1964 and corresponding fiscal years and thereafter, in any case in which the property factor is distorted by the taxpayer depreciating property in Wisconsin by a method different from that used to depreciate property outside Wisconsin, the department may determine the property factor by depreciating all property by the same method, or using original cost or any other means as will achieve an equitable result.

"(b) In the case of persons engaged in manufacturing or in any form of collecting, assembling or processing goods and materials, the ratio of the total cost of manufacturing, collecting, assembling or processing within this state to the total cost of manufacturing, or assembling or processing everywhere. The term 'cost of manufacturing, collecting, assembling, or processing,' as used herein, shall be interpreted in a manner to conform as nearly as may be to the best accounting practice in the trade or business. Unless in the opinion of the department of taxation the peculiar circumstances in any case justify a different treatment, this term shall be generally interpreted to include as elements of cost the following:

"1. The total cost of all goods, materials and supplies used in manufacturing, assembling or processing regardless of where purchased.

"2. The total wages and salaries paid or incurred during the income year in such manufacturing, assembling or processing activities.

"3. The total overhead or manufacturing burden properly assignable according to good accounting practice to such manufacturing, assembling or processing activities.

"(c) In the case of trading, mercantile or manufacturing concerns the ratio of the total sales made through or by offices, agencies or branches located in Wisconsin during the income year to the total net sales made everywhere during said income year."

Three factors are to be used in computing the apportionable income—sales, property and manufacturing costs. The Department weighted down the cost of manufacturing because not all of the products sold through Humble's marketing system in Wisconsin were manufactured by Humble.

Sec. 71.07(2)(b) provides that

"Unless in the opinion of the department of taxation the peculiar circumstances in any case justify a different treatment, this term [cost of manufacturing] shall

be generally interpreted to include as elements of cost the following. . . ."

The Department has employed weighting since 1932. Long-standing administrative construction of a statute is accorded great weight in the determination of legislative intent because the legislature is presumed to have acquiesced in that construction if it has not amended the statute. *Layton School of Art & Design* v. *WERC,* 82 Wis. 2d 324, 340, 262 N.W. 2d 218 (1978). The practice has also been approved by the Tax Appeals Commission and its predecessor, the Board of Tax Appeals, in *Kroger Company* v. *Wisconsin Dept. of Taxation,* 4 WBTA 319 (1956), and *Cooper's Inc.* v. *Wisconsin Dept. of Revenue,* 9 WTAC 342 (1973). The subdivisions of the statute set forth statutory ratios for the apportionment method but give the department considerable latitude in adopting a formula which will most accurately reflect a reasonable and equitable tax on the income earned in Wisconsin. *Interstate Finance Corp., supra,* 28 Wis. 2d at 271-72.

Exxon argues that the department lacked authority to adjust the apportionment ratios, because sec. 71.07(5) provides:

> "(5) If the income of any such person properly assignable to the state of Wisconsin cannot be ascertained with reasonable certainty by either of the foregoing methods, then the same shall be apportioned and allocated under such rules and regulations as the department of taxation may prescribe."

and the department had no published rules and regulations on the subject.

However, the department had sufficient authority to make such adjustments under sec. 71.07(2)(b), without relying on sec. 71.07(5).

The department, however, is not free to entirely disregard the statute. In *Department of Taxation* v. *Blatz Brewing Co.,* 12 Wis. 2d 615, 108 N.W. 2d 319 (1961), the department determined the location of returnable containers owned by Blatz for purposes of the property ratio by using the sales ratio. The court found this impermissible saying:

> "The action of the board of tax appeals, in holding that in the absence of definite proof, the property factor should be based on sales, was arbitrary and capricious. It follows that the allocation of these containers on sales alone, as was done in the modified additional assessment and approved by the board, or on the basis of 50 per cent to sales and 50 per cent to manufacturing, as now contended by the department, cannot be sustained, because those contentions are based on an erroneous theory and ignore the weight of the property factor in the formula. Such contentions reduce the three-factor formula to a two-factor formula in this case. The department is bound to use the statutory method even though another method may appear convenient or expedient to it." *Id.* at 627.

In the instant case, it is conceded that Humble had no manufacturing in the state, so the numerator of the cost of manufacturing ratio is zero. For purposes of calculating the denominator of the ratio, the department attempted to recognize only the cost of products manufactured by Humble and not those purchased from other vendors. To do this, the department used the ratio of net sales producing apportionable income to total manufactured products sold. This was improper under *Blatz.* We agree with the trial court that this question should be remanded to the Commission to determine whether the weighting method used by the Department was justified under the circumstances, and whether the formula as weighted unfairly apportioned the taxpayer's income for the years at issue. We also note that the burden of proving that the formula adopted unfairly apportioned Humble's income is on Exxon. *W. R. Arthur & Co.* v. *Dept. of Revenue,* 18 Wis. 2d 225, 232, 118 N.W. 2d 168 (1962).

By The Court: Judgment affirmed in part, reversed in part, and remanded for further proceedings consistent with this opinion.

APPENDIX B

STATE OF WISCONSIN
CIRCUIT COURT — DANE COUNTY

Case No. 151-344

WISCONSIN DEPARTMENT OF REVENUE,
Petitioner,

vs.

EXXON CORPORATION,
Respondent.

Before: Hon. George R. Currie, *Reserve Circuit Judge*

JUDGMENT

The above entitled review proceeding having been heard by the Court on the 18th day of January, 1977, at the City-County Building in the City of Madison; and the petitioner having appeared by Assistant Attorney General E. Weston Wood; and the respondent having appeared by Attorneys Thomas G. Ragatz, James F. Lorimer, Lloyd M. McBride, Robert E. Tannehill, and Paul D. Frenz; and the Court having had the benefit of the argument and briefs of counsel; and the Court having filed its Memorandum Decision wherein Judgment is directed to be entered as herein provided, which Memorandum Decision is incorporated herein by reference and made a part hereof;

It is Ordered and Adjudged that Findings of Fact Numbers 19, 21, and 23, and Conclusions of Law Numbers 3, 6, and 7, and the Order portion of the Decision of the Wisconsin Tax Appeals Commission dated April 8, 1976, entered in the matter of Exxon Corporation, f/k/a Humble Oil and Refining Company, Petitioner vs. Wisconsin Department of Revenue, Docket No. I-3806, be, and the same hereby are, set aside, and the matter be remanded to the Commission for further proceedings consistent with the Court's said Memorandum Decision.

Dated this 31st day of January, 1977.

By the Court:

George R. Currie
Reserve Circuit Judge

STATE OF WISCONSIN

CIRCUIT COURT — DANE COUNTY

Case No. 151-344

WISCONSIN DEPARTMENT OF REVENUE,

Petitioner,

vs.

EXXON CORPORATION,

Respondent.

Before: Hon. George R. Currie, *Reserve Circuit Judge*

MEMORANDUM DECISION

This is a proceeding under ch. 227, Stats., to review a decision of the Wisconsin Tax Appeals Commission (hereafter the Commission) dated April 8, 1976, which modified the action taken by petitioner department on respondent Exxon's application for abatement of assessment of additional income and franchise taxes for the calendar years 1965 through 1968.

During these four years the taxpayer whose operations in Wisconsin gave rise to this assessment of additional tax was Humble Oil and Refining Company, a wholly-owned subsidiary of Standard Oil Company of New Jersey. Later the latter corporation changed its name to Exxon Corporation.

THE COMMISSION'S FINDINGS OF FACT

The Commission's findings of fact read as follows:

Number 1. The petitioner is a corporation organized under the laws of the State of Delaware with its general offices located in Houston, Texas.

Number 2. During the years here under review, 1965 through 1968, Humble Oil and Refining Company was a wholly-owned subsidiary of Standard Oil Company of New Jersey. In early 1973, Humble Oil and Refining Company was merged into the parent company and the latter's name was changed to Exxon Corporation.

Number 3: The three principal operating or functional departments of the petitioner are exploration and production, refining, and marketing, each organized into regional geographic divisions. The marketing department has nation-wide jurisdiction and is headed by a vice-president located in Houston, Texas. Wisconsin is one of thirteen states in the central marketing region.

Number 4. The petitioner's three principal operating departments, exploration and production, refining, and marketing, were organized and operated as separate segments and separate functional operations of the petitioner's total corporate enterprise.

Number 5. During the years here under review, the petitioner's activity in Wisconsin was the marketing of refined petroleum products and automotive accessories. It had no exploration, production, or refining facilities located in Wisconsin.

Number 6. During the period here under review, the petitioner carried on its marketing operations in Wisconsin primarily through service stations, terminals, and bulk storage facilities.

Number 7. Pursuant to an exchange agreement between the petitioner and Pure Oil Company (a nonrelated company), gasoline and fuel oil were transported by the petitioner from Lemont, Illinois to its terminals in Wisconsin. Such products were sold by the petitioner in Wisconsin. None of the petitioner's own refined gasoline and fuel oil were sold in Wisconsin during the years 1965 through 1968.

Number 8. Motor oils, greases, and other packaged products were, during the period here under review, produced and manufactured by the petitioner outside of Wisconsin and were shipped into Wisconsin for sale in Wisconsin from petitioner's central warehouse facilities in Chicago, Illinois and from other out-of-state locations.

Number 9. During the period here under review, tires, batteries, and accessories were centrally purchased by the petitioner's purchasing office in Houston, Texas and were shipped from out-of-state locations into Wisconsin for sale.

Number 10. The petitioner utilized internal transfer prices between its functional departments that were the equivalent of third-party competitive prices.

Number 11. During the period here under review, the petitioner's exploration and production and refining departments had no operations or activities in the State of Wisconsin.

Number 12. During the period here under review, the petitioner carried on centralized purchasing for all its operating divisions; and centralized advertising was directed from the home office in Houston, Texas on a uniform nation-wide basis.

Number 13. During the period involved herein, key employees of the petitioner were transferred from one department to another as a method of employee training.

Number 14. During the period involved herein, the petitioner used a uniform credit card system throughout the United States including Wisconsin.

Number 15. During the period here under review, the petitioner utilized centralized accounting methods under the direction of its Houston home office.

Number 16. During the period here under review, the petitioner had in effect a company-wide stock option and bonus plan, which included its Wisconsin operations.

Number 17. During the period here under review, the petitioner's home office in Houston, Texas was responsible for and/or directed pricing policy, drafting of uniform selling forms and contracts, product guarantees or warranties, establishment of sales districts, negotiation and execution of exchange agreements, location of new service station outlets, approval of operating budgets, banking and investment of funds, utilization of legal services, preparation of federal and state tax reports, borrowing money, approval of salary increases and retirement plans, paid vacation plans, and health and accident insurance, all on a company-wide basis.

Number 18. During the period involved herein, income derived from each of the petitioner's functional operating departments could be determined from the petitioner's books and records.

Number 19. The petitioner's three main functional operating departments, exploration and production, marketing, and refining, were each unitary businesses.

Number 20. During the period involved herein, the petitioner's marketing operations in Wisconsin were not an integral part of the petitioner's exploration and production function.

Number 21. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its exploration and production function.

Number 22. During the period involved herein, the petitioner's marketing operations in Wisconsin were not an integral part of the petitioner's refining function.

Number 23. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its refining function.

Number 24. During the period involved herein, the petitioner's Wisconsin marketing operations were an integral part of the petitioner's overall marketing function.

Number 25. The petitioner filed Wisconsin corporation franchise or income tax returns for the calendar years 1965 through 1968 based on the separate accounting method of reporting its income to the State of Wisconsin. In said returns, losses were shown in the amounts of $821,320, $1,159,830, $1,026,224 and $919,575, respectively, for such years.

Number 26. Under date of June 25, 1971, the respondent, Wisconsin Department of Revenue, issued a notice of assessment of additional income and franchise taxes against the petitioner, Exxon Corporation, covering the years 1965 through 1968.

Number 27. In said assessment, the respondent determined that the petitioner realized additional net income in the amounts of $759,371, $1,043,395, $1,264,946, and $1,464,443 for the years 1965 through 1968, respectively, and computed additional Wisconsin franchise tax thereon totaling $316,470.85.

Number 28. The assessment here under review was based on a field audit of the petitioner's books and records conducted by the respondent covering the years here under review. In the course of said audit, the respondent determined that the petitioner's separate accounting method of reporting its income to the State of Wisconsin did not accurately reflect its Wisconsin taxable income. The respondent recomputed the petitioner's income/franchise tax liability on the three-factor apportionment basis provided for in Section 71.07 of the Wisconsin Statutes, and further weighted the cost-of-manufacturing factor in the formula it utilized.

Number 29. Under date of July 21, 1971, the petitioner filed an application for abatement of the said additional assessment with the respondent.

Number 30. Under date of November 30, 1971, the respondent denied the said application for abatement.

Number 31. On December 30, 1971, the petitioner filed a petition for review with this Commission.

Number 32. The apportionment formula utilized by the respondent had the effect of imposing a tax on the petitioner's exploration and production and on its refining net income, all of which was derived solely from operations outside the State of Wisconsin and which had no integral relationship to the petitioner's marketing operations within Wisconsin.

Number 33. The respondent's taxation of net income from the petitioner's exploration, production and refining functions subjects the petitioner to multiple-state taxation as to such income.

Number 34. The apportionment formula used by the respondent in the matter here in dispute utilized a calculation method differing from the statutory format of Section 71.07 of the Wisconsin Statutes.

Number 35. The petitioner's method of reporting its income to Wisconsin on a separate accounting basis did not accurately reflect its Wisconsin income.

The department challenges Findings Numbers 4, 19, 20, 21, 22, 23, 32, 33 and 34 as being erroneous conclusions of law and not true findings of fact, and contends that, if it does not prevail on that ground as to any of such findings, then the Court should determine that such findings are not supported by substantial evidence in the record.

The Court is satisfied that Findings Numbers 4, 33, and 34 are true findings of fact; and determines they are supported by substantial evidence in the record except possibly that portion of Finding Number 33 which in effect finds that the inclusion of income from taxpayer's refining functions in the apportionment formula applied by the department in making the assessment of additional tax subjected taxpayer to multiple-state taxation as to such income.

With respect to the other challenged findings the Court determines that they are either wholly or partially conclusions of law, and will be hereinafter dealt with.

The failure of the department to challenge any of the findings of fact other than the nine listed above amounts to a concession of the facts stated in the remaining twenty-six findings of fact.

THE COMMISSION'S CONCLUSIONS OF LAW

Neither party challenges Conclusions of Law Numbers 1 and 2. The remaining conclusions of law read:

> Number 3. During the years in issue, the petitioner was operating a multi-state unitary marketing business within the intent and meaning of Section 71.07(2) of the Wisconsin Statutes, and the petitioner's Wisconsin marketing operation was an integral part thereof.
>
> Number 4. Under the provisions of Section 71.07(2) of the Wisconsin Statutes, it was mandatory for the petitioner to use the apportionment method of reporting its income for Wisconsin franchise tax purposes.
>
> Number 5. The apportionment formula used by the respondent in the matter here in dispute utilized a calculation method differing from the statutory format of Section 71.07 of the Wisconsin Statutes.
>
> Number 6. The apportionment formula used by the respondent in the audit and assessment here under review was improper in including income from petitioner's exploration, production and refining departments, and resulted in assessing a tax on an extra-territorial income earned by the petitioner.
>
> Number 7. An apportionment formula, apportioning income earned by the petitioner from its marketing function within and without the State of Wisconsin, would be proper and within the intent and meaning of the statutory mandate contained in Section 71.07(2) of the Wisconsin Statutes.

The effect of these conclusions of law was that the Commission determined that Humble's marketing department,

which encompassed all business which it transacted in Wisconsin, was in itself a unitary business and for purposes of Wisconsin's income and franchise tax its income was to be taxed according to the apportionment formula set forth in sec. 71.07(2) Stats., as that statute read during the years at issue.

HUMBLE'S CORPORATE ORGANIZATION STRUCTURE

Humble's corporate organizational structure during the years at issue was subdivided into these three parts: Corporate management, coordination and services management, and operations management. In this review the Court is concerned only with operations management.

Operations management was responsible for directing the operating activities of the several individual functional segments of Humble's business which consisted of exploration and production, refining, marketing, marine, coal and shale oil, minerals, and land management. For the purposes of this decision the exploration and production function will be referred to as the exploration and production department although actually composed of three departments, viz., exploration, production, and natural gas.

The three departments dealt with in the Commission's findings of fact are exploration and production, refining, and marketing. Each of these three functional departments had a full management complement, and each was a separate profit center having its own accounting office which recorded and reported the cost analysis and the financial results of its operations.

STATUTES INVOLVED

The statutory provisions here quoted under this heading are those in effect during 1965 through 1968.

Section 71.01(2) provided in part:

> "(2) *Franchise Tax on Corporations.* For the privilege of exercising its franchise or doing business in this state in a corporate capacity every . . . foreign corporation . . . shall annually pay a franchise tax according to or measured by its entire net income of the preceding income year at the rates set forth in S. 71.09 (2am). . . . All provisions of Chs. 71 and 73 relating to net income taxation of corporations shall apply to franchise taxes imposed under this subsection, unless the context requires otherwise. . . ."

Section 71.07 provided in part:

> "(1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived. . . ."
>
> "(2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible,

> the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient; provided, that in the case of income which follows the residence of the recipient, the amount of interest and dividends deductible under this provision shall be limited to the total interest and dividends received which are in excess of the total interest (or related expenses, if any) paid and allowable as a deduction under section 71.04 during the income year. The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios:
>
> "(a) The ratio of the tangible property, real, personal, and mixed, owned and used by the taxpayer in Wisconsin in connection with his trade or business during the income year to the total of such property of the taxpayer owned and used by him in connection with his trade or business everywhere. Cash on hand or in the bank, shares of stock, notes, bonds, accounts receivable, or other evidence of indebtedness, special privileges, franchises, good will, or property the income of which is not taxable or is separately allocated, shall not be considered tangible property nor included in the apportionment. In determining apportionable net income with respect to the calendar year 1964 and corresponding fiscal years and thereafter, in any case in which the property factor is distorted by the taxpayer depreciating property in Wisconsin by a method different from that used to depreciate property outside Wisconsin, the department may determine the property factor by depreciating all property by the same method or using original cost or any other means as will achieve an equitable result.
>
> "(b) In the case of persons engaged in manufacturing or in any form of collecting, assembling or processing goods and materials, the ratio of the total cost

of manufacturing, collecting, assembling or processing within this state to the total cost of manufacturing, or assembling or processing everywhere. The term 'cost of manufacturing, collecting, assembling, or processing', as used herein, shall be interpreted in a manner to conform as nearly as may be to the best accounting practice in the trade or business. Unless in the opinion of the department of taxation the peculiar circumstances in any case justify a different treatment, this term shall be generally interpreted to include as elements of cost the following:

"1. The total cost of all goods, materials and supplies used in manufacturing, assembling or processing regardless of where purchased.

"2. The total wages and salaries paid or incurred during the income year in such manufacturing, assembling or processing activities.

"3. The total overhead or manufacturing burden properly assignable according to good accounting practice to such manufacturing, assembling or processing activities.

"(c) In the case of trading, mercantile or manufacturing concerns the ratio of the total sales made through or by offices, agencies or branches located in Wisconsin during the income year to the total net sales made everywhere during said income year.

"* * *

"(5) If the income of any such person properly assignable to the state of Wisconsin cannot be ascertained with reasonable certainty by either of the foregoing methods, then the same shall be apportioned and allocated under such rules and regulations as the department of revenue may prescribe."

WISCONSIN ADMINISTRATIVE CODE RULE INVOLVED

Rule TAX 2.42 provides in part:

"TAX 2.42. Apportionment method. (Section 71.07(2), Wis. Stats.) Any person engaged in business within and without the state must report by the statutory apportionment method when the business of such person within the state is an integral part of a unitary business, unless the department of taxation expressly permits reporting on a different basis."

PROCEDURAL ISSUES AND THEIR DISPOSITION

These two procedural issues are raised by the briefs:

(1) Did the Commission err as a matter of law in refusing to take judicial notice pursuant to motion made by the department of two bound volumes entitled "The Petroleum Industry, Hearings Before the Subcommittee on Anti-Trust and Monopoly of the Committee on the Judiciary, United States Senate, September 23, 26, October 29, 31, November 12, and 19, 1975, part 1 and part 2"?

(2) Is the scope of review by this Court governed by sec. 227.20(1), Stats., 1973, or by sec. 227.20, (1)-(9), as created by Section 25 of Chap. 414, Laws of 1975, effective September 22, 1976?

(a) *Judicial Notice Issue*

This issue was raised by a supplement to the department's original brief, which supplement is dated October 27, 1976. It appears therefrom that the Commission's ruling on the department's motion to take judicial notice of the two bound volumes described above was by oral ruling made April 7, 1976. The department's supplement to its brief stresses these two portions of the two bound volumes of which it desired to have judicial notice taken: (1) A

letter dated January 6, 1976, from Exxon's controller, A. L. Monroe, to Senator Hart, Chairman of the Senate Subcommittee; and (2) Exxon's answers to a request made to it by the South Carolina Tax Commission to admit certain facts, which request was made in a court action pending in a state court in South Carolina. These answers by Exxon were verified by the oath of a vice president on November 21, 1975. The department contended that this material conflicted with testimony given in behalf of Exxon at the hearing before the Commission with respect to Humble's method of separate accounting being maintained with respect to each of its operating departments, and that Humble's business during the four tax years here involved was not a unitary business. The department asserts that judicial notice should have been taken of this material because it bore on the credibility of witnesses who had testified at the hearing.

It thus appears that the particular facts of which the department sought to have judicial notice taken were adjudicative and not legislative facts. Wisconsin recognizes the distinction between adjudicative and legislative facts for purposes of taking judicial notice. Sec. 902.01, Stats., and Judicial Council Committee's Note to sub. (1) thereof set forth in 56 Marquette Law Rev. (1973) 173; *Fringer* v. *Venema* (1965), 26 Wis. 2d 366, 132 N.W. 2d 565. Sub. (1) of sec. 902.01, Stats., provides that this section of the statutes only governs adjudicative facts, and sub. (2) provides:

> "A judicially noticed fact must be one not subject to reasonable dispute in that it is either (a) generally known within the territorial region of the trial court or (b) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned."

While sec. 227.10(1), Stats., provides that administrative agencies shall not be bound by common law or statutory rules of evidence, the Commission had the right in its discretion to apply sec. 902.01(2), Stats., and deny the department's request to take judicial notice of the Monroe letter and Exxon's admission of facts in the South Carolina court action as not being supplied by sources whose accuracy cannot reasonably be questioned. A further sound basis for denial was that the facts covered by the Monroe letter and the admission of facts were too remote in time to the years 1965 through 1968, and related to Exxon as a whole and not to its former subsidiary Humble.

Obviously what the department was attempting to do was to get evidence before the Commission which the department considered to be admissions by Exxon. Judicial notice is not the proper method to be employed in proving admissions.

(b) *Which Statute Governs the Scope of Review*

This Court recently had before it the issue of whether the provisions of sec. 227.20(1), Stats., as it stood prior to its repeal and the creation of new sec. 227.20(1)-(9) by ch. 414, Laws of 1975, in *Town of Hewitt* v. *Wisconsin Department of Natural Resources,* Case No. 151-148, Dane County Circuit Court (December 3, 1976). The new statute had become effective September 22, 1976, after the date of the agency decision had been rendered, but prior to the Court's review thereof. The Court held that the new statute was a procedural and not a substantive statute and therefore governed the scope of the Court's review. On further consideration the Court deems this is true except as to any provision which narrowed the scope of review, and no contention has been advanced here that any provision does this.

The Court can perceive no practical distinction between the application of former sec. 227.20(1)(d) and new sec. 227.20(6) with respect to the power of the reviewing court to set aside agency findings not supported by substantial evidence. The decisions of the Wisconsin Supreme Court defining substantial evidence under former sec. 227.20 (1)(d) are equally applicable to what constitutes substantial evidence under new sec. 227.20(6).

The scope of review with respect to setting aside agency decisions for error of law appear to be the same under new sec. 227.20(8) and former sec. 227.20(1)(b).

ISSUES GOING TO MERITS OF CONTROVERSY

The issues raised with respect to the merits of the controversy are:

(1) Was taxpayer Humble a unitary business within the meaning of sec. 71.07(2), Stats., as that statute existed during the years 1965 through 1968?

(2) If Humble was a unitary business, did the department err in its interpretation of sec. 71.07(2), Stats., by including in the formula income which should have been excluded as situs income?

(3) Did the department err in adopting an apportionment formula which did not follow that prescribed by sec. 71.02(2), Stats., as it existed in the years at issue?

HUMBLE AS A UNITARY BUSINESS

Section 71.07(2), Stats., as it existed during the years 1965 through 1968 had the effect of requiring the application of an apportionment formula in determining the income and franchise tax of a taxpayer whose business in Wisconsin was "an integral part of unitary business", and

permission had not been properly granted by the department to employ the allocation and separate accounting method of reporting.

There have been several Wisconsin Supreme Court cases which have dealt with the problem of what constitutes a unitary business for the purposes of this statute. While there may not exist any inconsistency in result in these cases it appears that there has been some shifting in the criteria employed to determine what constitutes a unitary business for purposes of this statute. This Court is satisfied that the Supreme Court in *Interstate Finance Corp.* v. *Dept. of Taxation* (1965), 28 Wis. 2d 262, 137 N.W. 2d 38, has adopted the test of a unitary business which it will adhere to in future decisions. The opinion in that case was written by the present Chief Justice of the Court. The test thus adopted is one set forth in Allocation of Income in State Taxation (2d ed.) by Altman & Keesling, p. 101, and appears in this quotation therefrom in the opinion (at p. 269):

> " '. . . the essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. If there is such a relationship the business is unitary.' "

Keesling, (his name was misspelled "Kiesling" in *Interstate Finance Corp.*) one of the two authors of *Allocation of Income in State Taxation* (2d ed.), testified at the hearing before the Commission as an expert witness for the department. He pointed out that the test set forth in the above quotation from the book is in the alternative and not the conjunctive. As Exxon points out, however, in an article Keesling co-authored in 12 Hastings Law Journal (1960) 42, 48, entitled The Unitary Concept, it was stated that dependency alone was not sufficient to make a business

conducted in more than one state unitary. When questioned on cross examination about this change in view, he explained that it was the result of a decision by the California Supreme Court in the *Superior Oil Co.* case. This case is probably *Superior Oil Co.* v. *Franchise Tax Board* (1963), 34 Cal. Rptr. 545, 386 P.2d 33. This is probably all beside the point because the *Interstate Finance Corp.* case has adopted the alternative and not the conjunctive test.

Finding of Fact Numbers 7, 8, and 9 describe the sources from which Humble's sales outlets in Wisconsin, part of its marketing department, obtained the products which were sold there. All gasoline and fuel oil were obtained from Pure Oil Company (a non-related company) at Lemont, Illinois, and transported into Wisconsin pursuant to an exchange agreement whereby an equal supply of gasoline and fuel oil was supplied to Pure Oil Company by Humble at a location in a state other than Illinois or Wisconsin. This gasoline and fuel oil exchanged by Humble had been processed at one of its refineries from crude oil produced by it from its oil wells. Motor oils, greases, and other products sold in Wisconsin were produced and manufactured by Humble outside Wisconsin. Tires, batteries and other accessories sold in Wisconsin were centrally purchased by Humble's purchasing office in Houston, Texas.

There was no financial dependency by Humble's marketing department activities in Wisconsin because the transfer prices utilized by Humble with respect to the products sold in Wisconsin in the separate accounting maintained for its marketing department were the equivalent of third-party competitive prices as found by Finding of Fact Number 10. In other words the marketing department could have gone into the open market and bought these products at the same prices as the transfer prices charged to it in Humble's accounting procedures.

In the *Interstate Finance Corp.* case it was argued that the Wisconsin branches of taxpayer could have borrowed the money they needed to operate their finance operations from the same sources as home management had utilized and could have operated successfully without control or supervision of the home management. However, the Supreme Court held they could not operate independently because of the policies, direction and control of the home office, and this constituted a dependency. While Humble's marketing department operated with a great deal of autonomy from central management, it would be wholly unreasonable to conclude that central management would have permitted its marketing department to acquire the products Humble sold in Wisconsin from sources other than Humble.

The Wisconsin operation contributed sales to Humble's business of producing, refining and marketing petroleum products. This contribution was sufficient alone in the opinion of this Court to make Humble's business a unitary one. The profitability of the sales contributed is not an element to be considered in determining whether a unitary business existed.

Whether a business is unitary within the meaning of sec. 71.07(2), Stats., as it existed in the years 1965 through 1968, presents a question of law and not of fact. Therefore, any findings of fact which have the effect of determining that Humble's marketing department's operations were not part of a unitary business are erroneous conclusions of law. The Court will now consider certain findings of fact which the department has attacked as being erroneous conclusions of law.

Finding of Fact Number 19 is an erroneous conclusion of law in holding that Humble's three main functional operating departments were each unitary businesses.

Finding of Fact Number 20 held that Humble's marketing operations in Wisconsin were not an integral part of Humble's exploration and production function. It is immaterial that the gasoline and fuel oil sold in Wisconsin were not produced by Humble's oil wells, but were procured through an exchange made with Pure Oil Company. What made possible the exchange was the furnishing of Pure with gasoline and fuel oil by Humble which had their source in Humble's oil wells. Because both Humble's marketing operations in Wisconsin and its exploration and production function are integral parts of a unitary business does not mean that each is an integral part of the other. The Court can perceive no reason for disturbing this finding.

For the same reason the Court will not set aside Finding of Fact Number 22.

Finding of Fact Numbers 21 and 23 found there was no economic dependence between Humble's Wisconsin marketing operations and either its exploration and production function or its refining function. The Court has determined that there was such economic dependence because Humble depended upon its exploration and production function and its refining function to provide its Wisconsin marketing operations with the gasoline and fuel oil sold in Wisconsin even though none of such gasoline and fuel oil sold in Wisconsin had its origin in Humble's oil wells. Therefore, these two findings are erroneous conclusions of law.

Finding of Fact Number 32, as well as Finding of Fact Numbers 20 and 22, are couched in terms of one department being an integral part of another department and will not be set aside.

In conclusion the Court determines that the business of Humble during the years in question considered as a whole

both within and without Wisconsin constituted a unitary business within the meaning of sec. 71.07(2), Stats., as that statute existed during the years 1965 through 1968.

EXCLUSION OF SITUS INCOME

Section 71.07(1), Stats., as it existed in 1965 through 1968, contained this provision:

> "Income or loss *derived from* rentals and royalties from real estate or tangible personal property, or from the operation of any farm, *mine* or quarry, or from the sale of real property or tangible personal property shall follow the *situs* of the property from which *derived.*" (Emphasis supplied.)

While sec. 71.07(1) governs taxation of income from a business not requiring apportionment, a comparable provision to that quoted above serving a like purpose was set forth in sec. 71.07(2) as it existed during the years at issue, read:

> "In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer *such part thereof* (less related expenses, if any) as follows the situs of the *property . . . of the recipient . . . .*" (Emphasis supplied.)

With respect to what income follows the situs of the property it is clear that this is spelled out in the extract from sec. 71.07(1) quoted above. It was fully conceded by witnesses from the department that the extraction and production of oil and gas is "mining" within the meaning of Section 71.07(1) (Exhibit 7, pp. 71, 72, 81; Exhibit 8, p. 74; Exhibit 9, p. 15; Exhibit 10, p. 12). And in two recent cases the Commission has held oil and gas operations to be situs operations under Section 71.07(1): *Leonard R. Jevne* v. *Wisconsin Department of Revenue* Docket No.

I-4956; April 14, 1976 (CCH par. 201-224); *Deane A. Neitzel* v. *Wisconsin Department of Revenue,* Docket No. I-4872; November 17, 1975 (CCH par. 201-186).

In this case with respect to crude oil produced by Humble the department devised and applied what is termed the "barrel formula" as a means of separating two sets of income figures: (a) that derived from the sale to third parties of crude oil produced by Humble; and (b) that derived from crude oil produced by Humble and transferred to its refineries. The former was allocated to situs and the latter was left in the apportionment formula.

It is conceded that the part of Humble's production of crude oil which was transferred to its refining department was charged to that department in all instances at a transfer price based on "posted field prices", or at the identical prices received by Humble for the sale of that portion of its production of crude oil sold to outsiders.

In the case of gas produced by Humble, some dry gas was sold to third parties at the wellhead; some "wet" gas was run through field separators and then sold to third parties; much of the "wet" gas was run through so-called gas plants, where a more sophisticated separation process took place (but with no molecular or chemical change taking place), after which some sales were made to third parties and the balance was introduced into Humble's transmission system for sales along that system; and, with respect to usage by Humble, some of its produced gas was used by it in the production field and some (about 4%) was transferred for fuel consumption (not product conversion) to Humble's refineries. Such of the gas as was employed for field use by Humble or transferred for fuel consumption at Humble's refineries was valued at arm's length field prices.

As in the case of the crude oil, the department attempted to segregate the income derived from sales of gas to third parties which it treated as excludable situs income, and all other income of Humble's production department from gas production was made subject to apportionment even though in Humble's accounting for that department such gas had been valued at arm's length field prices.

It is very clear to the Court that the department did not exclude from Humble's income subject to the application of the apportionment formula all situs income that was *derived* by Humble from its oil and gas wells. Humble's accounting records establish what the total of that situs income was based upon the value of the crude oil at posted field prices and of the gas at arm's length field prices.

The fact that part of Humble's production of crude oil was refined in its refining department and the end products sold through its marketing department is a proper factor taken into consideration in determining its business during the years at issue as having been a unitary one. However, this did not enhance the value of the crude oil and gas at wellhead beyond such posted field prices of crude oil and field prices of gas. There is nothing in the record alluded to in the briefs which give any indication that there was not a ready market for all of the crude oil and gas Humble produced. The evidence is undisputed that some companies in the petroleum industry engage only in the functions performed by Humble's exploration and production department.

It is the department's theory that non-apportionable situs income must be confined to *realized* income from actual sales to third parties. Nowhere, however, does the statute speak in terms of *realized* income in excluding situs income from application of the apportionment formula; it speaks only in terms of *derived* income.

The Commission expressly found by Finding of Fact Number 33 that the department's taxation of net income derived from Humble's exploration and production functions subjected Humble to multiple state taxation as to such income. This finding is supported by the testimony of Wehner, an expert witness in the field of accounting and taxation of the petroleum and gas industries. At the time of testifying he was the head of the Houston office of Arthur Andersen & Company, one of the largest firms of certified public accountants in the country. Prior to that for fifteen years he had been in charge of oil and gas taxation policies for the entire firm, not merely its Houston office. He had also served as special consultant to the United States Treasury Department. He testified Texas, Louisiana, Oklahoma, Colorado and probably California impose severance taxes on oil and gas production; and the posted field prices for crude oil and the Fiske formula method of back-up to wellhead gas prices are used in determination of values for these severance taxes. Thus there is no question but that the department's inclusion of Humble's income derived from crude oil and gas produced and not sold to third parties by Humble's production department resulted in double taxation of such income.

This feature of double taxation of situs income was emphasized by the Minnesota Supreme Court in *Skelly Oil Company* v. *Commission of Taxation* (1964), 239 Minn. 351, 131 N.W.2d 632, in refusing to permit income from Skelly's out-of-state production activities to be taxed by an apportionment formula applicable to a unitary business. In its decision that court declared (131 N.W. 2d 632 at p. 643):

> ". . . Skelly's production income was already subject to being taxed in full at the point of production. While taxation of the same income more than once

> may not be unlawful, depending upon circumstances, *Cream of Wheat Co.* v. *County of Grand Forks,* 253 U.S. 325, 330, 40 S.Ct. 558, 560, 64 L. Ed. 931, 934, it is nevertheless offensive to common concepts of what constitutes fairness, particularly when it is multiple taxation of the sort the board's unsupported conclusion produces in the instant case."

Likewise the department's attempt to interpret the situs exclusions of secs. 71.07(1) and 71.07(2) so as to only exclude Humble's income from crude oil and gas sold to third persons at situs of origin, and subjecting the remainder of such situs income to taxation through application of an apportionment formula with resulting double taxation of the same, is offensive to this Court's concept of what constitutes fairness. The Court does not believe that this unfair result was intended by the legislature. The intent of the legislature is made clear by the opening sentence of sec. 71.07(2), Stats., "Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state."

The department's reply brief contends that the department's interpretation of the situs exclusionary provision of sec. 71.07(2) is a reasonable one and should be accorded weight because it is one the department has followed for some years. The Court deems that *Transamerica Financial Corp.* v. *Wisconsin Dept. of Revenue* (1972), 56 Wis. 2d 57, 201 N.W. 2d 552, repudiates that argument. There the department sought to limit the deduction of interest and dividends received as against the taxpayer's claim for *total* deduction before the application of the apportionment formula. The Supreme Court flatly held for the taxpayer by observing that "total" means "all, not part". And in countering the department's plea that its action

was consistent with long, established custom, the Court succinctly observed (56 Wis. 2d 67, 201 N.W. 2d at 557):

> "The department further argues that the assessments made here are in accord with the interpretation of the statute for many years, since 1932, and is entitled to great weight in construing the statute. We think administrative construction is not to be given force where it is inconsistent with an unambiguous statutory provision. . . ."

It is the Court's determination that on remand in computing the net income of Humble for the four tax years at issue which is subject to the apportionment formula there shall be deducted from the total net income such part thereof as constitutes situs income derived from the production of crude oil, whether sold to third parties by Humble's exploration and production department or transferred to its refining department, and all situs income derived from the production of natural gas as the same may be determined by the Commission.

Exxon's brief points out that the department in its audit upon which its assessment of tax was based made no deduction from net income attributable to Humble's functional operations identified as "Marine", "Coal and Shale Oil", "Minerals" and "Land Management". As the titles of these operations indicate, they are involved in shipping operations and in the exploration for and mining and extraction of coal, minerals and shale oil and the rental and sale of real estate, some at least being situs income operations (Tr. Vol. III, pp. 3-7). Therefore, on remand the Commission shall determine the amount of any situs income derived from these operations properly deductible from Humble's total net income for the years at issue in determining the amount of net income to which the apportionment formula is to be applied.

VARIATIONS IN STATUTORY APPORTIONMENT FORMULA

In computing the apportionment formula prescribed by sec. 71.07(2), Stats., as it existed during the years at issue, the three factors to be utilized are sales, property, and manufacturing costs. Exxon's brief asserts that the department employed a divisor of approximately 2.6 in determining the arithmetical average instead of 3 as prescribed by the statute. On the other hand, the department's reply brief indicates that what the department did was to weight the cost of manufacturing labor because not all of the products sold through Humble's marketing department were manufactured by Humble. Finding of Fact Number 9 lists products of this kind not manufactured by Humble.

In support of the adjustment made by the department in the apportionment formula the department's reply brief cites the testimony of Hoel, its supervisory employee who signed the letter of assessment (Exhibit 1). He testified: If a company manufactures part of the goods it sells and purchases others, the cost of manufacturing factor should not receive the full importance of the other two factors. For example, if the company manufactures one-half of what it sells, this cost of manufacturing factor should receive only 50 percent weight (Tr. October 8, p. 145). This weighting procedure has been used by petitioner since 1932; under varying circumstances it may result either in increasing or decreasing taxable income (Tr. October 8, p. 144). The method of weighting may be based on the ratio of cost of manufactured products sold to total cost of sales, or on the ratio of the selling price of manufactured products to total sales. Exhibit 34 shows by examples the results achieved by weighting the cost of manufacturing factor.

There were in existence during the years at issue two statutory provisions which might be contended authorized the department to vary the apportionment formula because of the facts stressed in Hoel's above summarized testimony for doing so, viz., sec. 71.07(2)(b) and sec. 71.07(5), Stats.

Sec. 71.07(2)(b) provided:

> "Unless in the opinion of the department of taxation the peculiar circumstances in any case justify a different treatment, this term [cost of manufacturing] shall be generally interpreted to include as elements of cost the following:" (and then lists total costs of goods, materials and supplies, total wages and salaries, and total overhead and manufacturing burden properly assignable to manufacturing activities).

Sec. 71.07(5) provided:

> "If the income of any such person properly assignable to the state of Wisconsin cannot be ascertained with reasonable certainty by either of the foregoing methods, then the same shall be apportioned and allocated under such rules and regulations as the department of revenue may prescribe."

It will be noted that the department did not directly make any change in the cost of manufacturing factor but in averaging the three factors divided by approximately 2.6 instead of the prescribed statutory 3. However, sec. 83.6, pages 330-331 of the department's Training Manual (Exhibit 11-10A) states that this weighting of the manufacturing factor in a situation where the taxpayer does not manufacture all the goods it sells can be done either by reducing the cost of manufacturing factor before dividing by 3, or by making an adjustment in the divisor figure of 3. There is set forth this illustration of the latter method:

Factor	Weight		Percent to Wisconsin		Weighted Percent to Wisconsin
Property	1	x	15.93%	=	15.93%
Cost of Manufacturing	.25	x	0%	=	0%
Sales	1	x	22.14%	=	22.14%
Totals	2.25				38.07%

Average Percentage = 38.07% ÷ 2.25 = 16.92%

Authorization of the above method of weighting manufacturing costs where the taxpayer manufactures but part of the goods it sells in Wisconsin is set forth in Article 602.5 of the department's Income Tax Regulations (Exhibit 11-13). These regulations were adopted many years ago and were withdrawn in 1942 (Tr. Vol. V, p. 157), but the department has continued to weight manufacturing costs by the method set forth in its Training Manual.

Exxon contends that it was unlawful for the department to use such adjusted apportionment formula because the statutory words of sec. 71.07(5), Stats., "under such rules and regulations as the department of revenue may prescribe" required the existence of published rules and regulations. In support of this contention Exxon's brief cites *Celon Co.* v. *Department of Taxation* (1955), 269 Wis. 372, 382-383, 69 N.W.2d 453, wherein the Supreme Court stated:

> "It is true that the respondent [the department] has been given authority to make rules and regulations. Our attention is called to none that it has made under such section [sec. 71.07(5)]. We have checked carefully all of its rules in the Wisconsin Red Book, Administrative Rules and Orders, published in 1950 and we can find none referring to this portion of the statute. It clearly is not applicable."

However, the *Celon* case was not concerned with a problem of weighting manufacturing costs but with a conten-

tion by the department that where either of the methods, separate accounting or apportionment, is used by the taxpayer, if it does not properly assign to the state of Wisconsin the income attributable to Wisconsin, the department has the discretion to prescribe what method shall be followed in order to arrive at the correct Wisconsin taxable income. Here, if the department had directly reduced the cost of manufacturing to reflect only the percentage thereof which represented products sold that had been refined or otherwise manufactured by Humble, no published rules or regulations would have been required under the wording of sec. 71.07(2)(b), Stats. The fact that the department accomplished the identical result by weighting the divisor figure of 3 should not be a decisive factor. Therefore the Court determines that the applicable provision of sec. 71.07(2)(b) applies which does not require published rules and regulations.

The department's reply brief cites *W. R. Arthur & Co.* v. *Department of Taxation* (1962), 18 Wis. 2d 225, 230-231, 118 N.W. 2d 168. However, that case dealt with the taxation of a motor carrier operating both in Wisconsin and out-of-state, and the department substituted for the three factors constituting the apportionment formula prescribed in sec. 71.07(2), Stats., gross receipts, revenue miles, and payroll. The taxpayer did not challenge use of the factors of revenue miles and payroll, but objected to use of the gross receipts factor. The opinion of the Supreme Court cited sec. Tax 2.45, 6 Wis. Adm. Code, which provided that in special cases not falling within the statutory formula it "will substitute in the place of some or all of the statutory apportionment factors such other factor or factors as will reasonably apportion to Wisconsin the business income properly assignable to Wisconsin"; and held the taxpayer did not meet its burden of proving that the formula adopted

unfairly apportioned its income in Wisconsin. Here, no reliance has been placed by the department on sec. Tax 2.45, 6 Wis. Adm. Code, which is a published rule or regulation, and, therefore, the Court fails to see that the holding in that case is pertinent to the issue here under consideration.

More to the point is that the Commission and its predecessor, the Wisconsin Board of Tax Appeals, approved the department's use of the weighting method of varying the statutory apportionment formula in *Kroger Company* v. *Wisconsin Department of Taxation* (1956), 4 WBTA 319, and in *Cooper's Inc.* v. *Wisconsin Department of Revenue* (1973), 9 WBTA 342.

On remand, it will be the duty of the Commission to determine whether the weighting apportionment formula here employed by the department was justified by the circumstances that Humble did not manufacture all of the products it sold in Wisconsin, and whether the formula as so weighted unfairly apportioned Humble's income in Wisconsin for the years at issue. In making such determination the Commission will keep in mind that the burden of proving that the formula adopted unfairly apportioned Humble's income in Wisconsin is on Exxon. *W. R. Arthur & Co.* v. *Department of Taxation*, supra, p. 232.

Let judgment be entered setting aside Finding of Fact Numbers 19, 21, and 23, and Conclusions of Law Numbers 3, 6, and 7, and the order portion of the Commission's decision here under review which ordered the department's action on Exxon's application for abatement to be modified in conformity to the Commission's findings and conclusions; and remanding the matter to the Commission for further proceedings consistent with this decision.

Dated this 31st day of January, 1977.

By the Court:

/s/ George R. Currie

Reserve Circuit Judge

APPENDIX C

STATE OF WISCONSIN
TAX APPEALS COMMISSION

EXXON CORPORATION, f/k/a Humble Oil and Refining Company,

Petitioner,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

DOCKET NO. I-3806

DECISION AND ORDER
(Drafted by Commissioner Timken)

The above-entitled matter having come on to be heard before this Commission; the petitioner, EXXON CORPORATION, f/k/a Humble Oil and Refining Company, having appeared by its Senior Vice-President, Oral L. Luper, and by its Tax Attorney, Robert E. Tannehill; and by its attorneys, Boardman, Suhr, Curry & Field, by Thomas G. Ragatz; and by its attorneys, McBride, Baker, Wienke & Schlosser, by Lloyd M. McBride and Paul D. Frenz; the respondent, WISCONSIN DEPARTMENT OF REVENUE, having appeared by its attorneys, Irving F. Shapiro and Robert M. Finley; and being fully advised in the premises, having considered the testimony, evidence and briefs of counsel, this Commission hereby finds and decides as:

FINDINGS OF FACT

1. The petitioner is a corporation organized under the laws of the State of Delaware with its general offices located in Houston, Texas.

2. During the years here under review, 1965 through 1968, Humble Oil and Refining Company was a wholly-owned subsidiary of Standard Oil Company of New Jersey. In early 1973, Humble Oil and Refining Company was merged into the parent company and the latter's name was changed to Exxon Corporation.

3. The three principal operating or functional departments of the petitioner are exploration and production, refining, and marketing, each organized into regional geographic divisions. The marketing department has nationwide jurisdiction and is headed by a vice-president located in Houston, Texas. Wisconsin is one of thirteen states in the central marketing region.

4. The petitioner's three principal operating departments, exploration and production, refining, and marketing, were organized and operated as separate segments and separate functional operations of the petitioner's total corporate enterprise.

5. During the years here under review, the petitioner's activity in Wisconsin was the marketing of refined petroleum products and automotive accessories. It had no exploration, production, or refining facilities located in Wisconsin.

6. During the period here under review, the petitioner carried on its marketing operations in Wisconsin primarily through service stations, terminals, and bulk storage facilities.

7. Pursuant to an exchange agreement between the petitioner and Pure Oil Company (a non-related company), gasoline and fuel oil were transported by the petitioner from Lemont, Illinois to its terminals in Wisconsin. Such products were sold by the petitioner in Wisconsin. None of the petitioner's own refined gasoline and fuel oil were sold in Wisconsin during the years 1965 through 1968.

8. Motor oils, greases, and other packaged products were, during the period here under review, produced and manufactured by the petitioner outside of Wisconsin and were shipped into Wisconsin for sale in Wisconsin from petitioner's central warehouse facilities in Chicago, Illinois and from other out-of-state locations.

9. During the period here under review, tires, batteries, and accessories were centrally purchased by the petitioner's purchasing office in Houston, Texas and were shipped from out-of-state locations into Wisconsin for sale.

10. The petitioner utilized internal transfer prices between its functional departments that were the equivalent of third-party competitive prices.

11. During the period here under review, the petitioner's exploration and production and refining departments had no operations or activities in the State of Wisconsin.

12. During the period here under review, the petitioner carried on centralized purchasing for all its operating divisions; and centralized advertising was directed from the home office in Houston, Texas on a uniform nation-wide basis.

13. During the period involved herein, key employees of the petitioner were transferred from one department to another as a method of employee training.

14. During the period involved herein, the petitioner used a uniform credit card system throughout the United States including Wisconsin.

15. During the period here under review, the petitioner utilized centralized accounting methods under the direction of its Houston home office.

16. During the period here under review, the petitioner had in effect a company-wide stock option and bonus plan, which included its Wisconsin operations.

17. During the period here under review, the petitioner's home office in Houston, Texas was responsible for and/or directed pricing policy, drafting of uniform selling forms and contracts, product guarantees or warranties, establishment of sales districts, negotiation and execution of exchange agreements, location of new service station outlets, approval of operating budgets, banking and investment of funds, utilization of legal services, preparation of federal and state tax reports, borrowing money, approval of salary increases and retirement plans, paid vacation plans, and health and accident insurance, all on a company-wide basis.

18. During the period involved herein, income derived from each of the petitioner's functional operating departments could be determined from the petitioner's books and records.

19. The petitioner's three main functional operating departments, exploration and production, marketing, and refining, were each unitary businesses.

20. During the period involved herein, the petitioner's marketing operations in Wisconsin were not an integral part of the petitioner's exploration and production function.

21. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its exploration and production function.

22. During the period involved herein, the petitioner's marketing operations in Wisconsin were not an integral part of the petitioner's refining function.

23. During the period involved herein, there was no economic dependence between the petitioner's Wisconsin marketing operations and its refining function.

24. During the period involved herein, the petitioner's Wisconsin marketing operations were an integral part of the petitioner's overall marketing function.

25. The petitioner filed Wisconsin corporation franchise or income tax returns for the calendar years 1965 through 1968 based on the separate accounting method of reporting its income to the State of Wisconsin. In said returns, losses were shown in the amounts of $821,320, $1,159,830, $1,026,224 and $919,575, respectively, for such years.

26. Under date of June 25, 1971, the respondent, Wisconsin Department of Revenue, issued a notice of assessment of additional income and franchise taxes against the petitioner, Exxon Corporation, covering the years 1965 through 1968.

27. In said assessment, the respondent determined that the petitioner realized additional net income in the amounts of $759,371, $1,043,395, $1,264,946, and $1,464,443 for the years 1965 through 1968, respectively, and computed additional Wisconsin franchise tax thereon totaling $316,-470.85.

28. The assessment here under review was based on a field audit of the petitioner's books and records conducted by the respondent covering the years here under review. In the course of said audit, the respondent determined that the petitioner's separate accounting method of reporting its income to the State of Wisconsin did not accurately reflect its Wisconsin taxable income. The respondent recomputed the petitioner's income/franchise tax liability on the three-factor apportionment basis provided for in Section 71.07 of the Wisconsin Statutes, and further weighted the cost-of-manufacturing factor in the formula it utilized.

29. Under date of July 21, 1971, the petitioner filed an application for abatement of the said additional assessment with the respondent.

30. Under date of November 30, 1971, the respondent denied the said application for abatement.

31. On December 30, 1971, the petitioner filed a petition for review with this Commission.

32. The apportionment formula utilized by the respondent had the effect of imposing a tax on the petitioner's exploration and production and on its refining net income, all of which was derived solely from operations outside the State of Wisconsin and which had no integral relationship to the petitioner's marketing operations within Wisconsin.

33. The respondent's taxation of net income from the petitioner's exploration, production and refining functions subjects the petitioner to multiple-state taxation as to such income.

34. The apportionment formula used by the respondent in the matter here in dispute utilized a calculation method differing from the statutory format of Section 71.07 of the Wisconsin Statutes.

35. The petitioner's method of reporting its income to Wisconsin on a separate accounting basis did not accurately reflect its Wisconsin income.

WISCONSIN STATUTES INVOLVED

Section 71.01 Imposition of tax; exempt income.

"(2) FRANCHISE TAX ON CORPORATIONS. For the privilege of exercising its franchise or doing business in this state in a corporate capacity every domestic or foreign corporation, except corporations specified in sub. (3), shall annually pay a franchise tax according to or measured by its entire net income of the preceding income year at the rates set forth in s. 71.09 (2am). Every corporation organized under the laws of this state shall be deemed to be residing within this state for the purposes of this franchise tax.

All provisions of chs. 71 and 73 relating to net income taxation of corporations shall apply to franchise taxes imposed under this subsection, unless the context requires otherwise. * * *."

Section 71.07 Situs of income; allocation and apportionment.

"(2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient; provided, that in the case of income which follows the residence of the recipient, the amount of interest and dividends deductible under this provision shall be limited to the total interest and dividends received which are in excess of the total interest (or related expenses, if any) paid and allowable as a deduction under section 71.04 during the income year. The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios:

"(a) The ratio of the tangible property, real, personal and mixed, owned and used by the taxpayer in Wisconsin in connection with his trade or business during the income year to the total of such property of the taxpayer owned and used by him in connection with his trade or business everywhere.

Cash on hand or in the bank, shares of stock, notes, bonds, accounts receivable, or other evidence of indebtedness, special privileges, franchises, good will, or property the income of which is not taxable or is separately allocated, shall not be considered tangible property nor included in the apportionment. In determining apportionable net income with respect to the calendar year 1964 and corresponding fiscal years and thereafter, in any case in which the property factor is distorted by the taxpayer depreciating property in Wisconsin by a method different from that used to depreciate property outside Wisconsin, the department may determine the property factor by depreciating all property by the same method or using original cost or any other means as will achieve an equitable result.

"(b) In the case of persons engaged in manufacturing or in any form of collecting, assembling or processing goods and materials, the ratio of the total cost of manufacturing, collecting, assembling or processing within this state to the total cost of manufacturing, or assembling or processing everywhere. The term 'cost of manufacturing, collecting, assembling, or processing', as used herein, shall be interpreted in a manner to conform as nearly as may be to the best accounting practice in the trade or business. Unless in the opinion of the department of taxation the peculiar circumstances in any case justify a different treatment, this term shall be generally interpreted to include as elements of cost the following:

"1. The total cost of all goods, materials and supplies used in manufacturing, assembling or processing regardless of where purchased.

"2. The total wages and salaries paid or incurred during the income year in such manufacturing, assembling or processing activities.

"3. The total overhead or manufacturing burden properly assignable according to good accounting

practice to such manufacturing, assembling or processing activities.

"(c) In the case of trading, mercantile or manufacturing concerns the ratio of the total sales made through or by offices, agencies or branches located in Wisconsin during the income year to the total net sales made everywhere during said income year."

WISCONSIN ADMINISTRATIVE CODE INVOLVED

Rule TAX 2.42 provides in part:

"TAX 2.42 Apportionment method. (Section 71.07 (2), Wis. Stats.) Any person engaged in business within and without the state must report by the statutory apportionment method when the business of such person within the state is an integral part of a unitary business, unless the department of taxation expressly permits reporting on a different basis."

CONCLUSIONS OF LAW

1. The petitioner's income/franchise tax returns prepared on a separate accounting basis did not properly reflect the income taxable by the State of Wisconsin for the years in issue, as required by Section 71.07(2) of the Wisconsin Statutes.

2. The respondent's action was proper in refusing to permit the petitioner's separate accounting method of reporting its income for the years here in issue.

3. During the years in issue, the petitioner was operating a multi-state unitary marketing business within the intent and meaning of Section 71.07(2) of the Wisconsin Statutes, and the petitioner's Wisconsin marketing operation was an integral part thereof.

4. Under the provisions of Section 71.07(2) of the Wisconsin Statutes, it was mandatory for the petitioner

to use the apportionment method of reporting its income for Wisconsin franchise tax purposes.

5. The apportionment formula used by the respondent in the matter here in dispute utilized a calculation method differing from the statutory format of Section 71.07 of the Wisconsin Statutes.

6. The apportionment formula used by the respondent in the audit and assessment here under review was improper in including income from petitioner's exploration, production and refining departments, and resulted in assessing a tax on extraterritorial income earned by the petitioner.

7. An apportionment formula, apportioning income earned by the petitioner from its marketing function within and without the State of Wisconsin, would be proper and within the intent and meaning of the statutory mandate contained in Section 71.07(2) of the Wisconsin Statutes.

Therefore,

IT IS ORDERED

That the respondent's action on the petitioner's application for abatement be and the same is hereby modified in conformity with the Findings and Conclusions contained above, and as modified, is affirmed.

Dated at Madison, Wisconsin, this 8th day of April, 1976.

WISCONSIN TAX APPEALS COMMISSION

R. J. Surz
R. J. Surz, Chairman
Thomas R. Timken
Thomas R. Timken, Commissioner
John P. Morris
John P. Morris, Commissioner

APPENDIX D

SUPREME COURT OF WISCONSIN

Wisconsin Department of Revenue,
Petitioner-Appellant,
and Cross-Respondent,

v.

Exxon Corporation,
Respondent and
Cross-Appellant.

Appeal No. 76-751

REMITTITUR

This cause was an appeal to review the judgment of the Circuit Court of Dane County. On consideration whereof, it is now here ordered and adjudged by this Court in an opinion filed on June 29, 1979, that the judgment of the Circuit Court of Dane County, in this cause is affirmed in part, reversed in part, and remanded for further proceedings consistent with this opinion.

The appeal record is hereby returned to the Clerk of Courts for Dane County.

I certify that the above is a correct transcript of the original order and judgment of the court in the above entitled cause.

Dated this 7th day of
August, 1979.

/s/ *Kay Wacker, Deputy*
Clerk of the Supreme Court of the State of Wisconsin

APPENDIX E

IN THE SUPREME COURT OF THE STATE OF WISCONSIN

EXXON CORPORATION,
Appellant,

v.

WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

NO. 76-751

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that EXXON CORPORATION, Appellant, hereby appeals to the Supreme Court Of The United States from the final judgment (except for that portion labeled "Question #3," 90 Wis. 2d at 731, 281 N.W.2d at 111) of the Supreme Court of the State of Wisconsin affirming in part and reversing in part a judgment of the Circuit Court for Dane County, Wisconsin, which final judgment was entered in this proceeding on June 29, 1979.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

FOLEY & LARDNER

By: /s/ *Thomas G. Ragatz*
First Wisconsin Plaza
1 South Pinckney Street
Madison, Wisconsin 53701

DATED: September 21, 1979

STATE OF WISCONSIN)
) SS:
COUNTY OF DANE)

IN THE SUPREME COURT OF THE STATE OF WISCONSIN

EXXON CORPORATION,

Appellant,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

NO. 76-751

AFFIDAVIT OF FILING OF NOTICE OF APPEAL FILED WITH THE SUPREME COURT OF WISCONSIN, WISCONSIN CIRCUIT COURT, DANE COUNTY, AND WISCONSIN TAX APPEALS COMMISSION AND OF SERVICE ON ALL PARTIES

I, Russell Feingold, being duly sworn under oath, state that, on this date, I have personally filed a Notice of Appeal with the Clerk of the Supreme Court of Wisconsin and copies thereof with the Clerks of the Wisconsin Circuit Court, Dane County and the Wisconsin Tax Appeals Commission, and have personally served a copy of the Notice of Appeal on counsel of record for Appellee at the following addresses:

Attorney General, State of Wisconsin
State Capitol Building
Madison, Wisconsin 53703

Wisconsin Department of Revenue
201 East Washington Avenue
Madison, Wisconsin 53703.

I further state that all parties required to be served with the Notice of Appeal filed by Exxon Corporation with the Wisconsin Supreme Court, the Wisconsin Circuit Court, Dane County, and Wisconsin Tax Appeals Commission have been served.

I further state that this Proof of Service has been filed with the Clerk of the Supreme Court of Wisconsin concurrently with the filing therewith of the Notice of Appeal.

DATED: September 21, 1979.

/s/ *Russell Feingold*
Russell Feingold
Foley & Lardner
One South Pinckney Street
Madison, Wisconsin 53701

SUBSCRIBED AND SWORN TO
before me this 21st day
of September, 1979.

/s/ *Thomas G. Ragatz*
Thomas G. Ragatz
Notary Public

APPENDIX F

71.07 (1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived.

APPENDIX G

71.07 (2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of revenue may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. * * *

APPENDIX H

WISCONSIN TAX APPEALS COMMISSION

HUMBLE OIL & REFINING COMPANY,

Petitioner,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

PETITION FOR REVIEW

Docket No. .....

To the Honorable Wisconsin Tax Appeals Commission:

COMES NOW Humble Oil & Refining Company (hereinafter called "Petitioner"), and hereby petitions for review of the Wisconsin Department of Revenue's (hereinafter called "Department") Notice of Denial of Application for Abatement dated November 30, 1971, and received December 3, 1971, a copy of which is attached hereto, and alleges as follows:

(1) *Petitioner.* Petitioner is a private corporation duly organized and existing under the laws of the State of Delaware, and is duly qualified to do business in the State of Wisconsin, having complied with all requirements of the laws of the State of Wisconsin. Petitioner's principal office is located at 800 Bell Avenue, Houston, Texas 77002.

(2) *Statement of Facts.* This petition involves Wisconsin corporation income and franchise taxes for the taxable years 1965-1968 inclusive. On June 25, 1971, the Department mailed to Petitioner a Notice of Additional In-

come and Franchise Taxes in the amount of $316,470.85, plus interest. Within thirty days thereafter, on July 21, 1971, Petitioner filed with the Department an Application for Abatement pursuant to Section 71.12, Wisconsin Statutes. Such Application was denied by the Department on November 30, 1971. This appeal is filed pursuant to and within the time prescribed by Section 73.01(5), Wisconsin Statutes. Petitioner denies that any additional income and franchise tax or interest was properly and legally determined, and denies that all or any portion thereof as thus determined is due and owing.

Petitioner is the successor to the Wisconsin properties and business of the Pate Oil Company of Milwaukee, Wisconsin, and during the period in question continued to operate such business as a separate and distinct entity. Its only business activity in the State of Wisconsin is the marketing of petroleum products and related accessories. All of Petitioner's activities in the State of Wisconsin have been and are treated as a separate unit, separately staffed and independent of and unrelated to Petitioner's activities carried on elsewhere.

Petitioner timely filed Wisconsin corporation income and franchise tax returns for the years 1965-1968, utilizing a direct accounting method for the reporting of its income from such independent Wisconsin activities pursuant to Section 71.07(2). The records from which these returns were prepared are maintained on a separate accounting basis. In the Department's assessment and Notice of Denial of Application for Abatement, the direct accounting method was disallowed, and the Department apportioned Petitioner's income under a method devised by the Department only for oil and gas companies.

(3) *Grounds for Objection.* Petitioner objects to the assessment of the alleged deficiencies on the following grounds:

(a) The Department's refusal to permit Petitioner to report the results of its separate Wisconsin unit on the basis of its separate accounting was arbitrary and capricious and denied Petitioner's right to use the separate accounting method under Section 71.07(2), Wisconsin Statutes, to clearly reflect its Wisconsin income.

(b) The Department, in disallowing the direct accounting method, failed to limit the imposition of the Wisconsin tax to Petitioner's income derived only from business transacted and property located within the State of Wisconsin as required and intended by Section 71.07(2), Wisconsin Statutes.

(c) Petitioner's business is not unitary in nature, and, consequently, its business in Wisconsin is not an integral part of a unitary business; and the Department's failure to impose the tax on an allocation and separate accounting method is arbitrary, capricious and illegal, and is in violation of the express provisions and intent of Section 71.07(2), Wisconsin Statutes.

(d) In the alternative, even if Petitioner's business were determined to be unitary in nature, its Wisconsin business is not an integral part of its unitary business, and the Department's failure to impose the tax on an allocation and separate accounting method is arbitrary, capricious and illegal, and is in violation of the express provisions and intent of Section 71.07(2), Wisconsin Statutes.

(e) In the alternative, regardless of whether or not it be determined that the Petitioner's business is unitary in nature and that the Petitioner's business in Wisconsin is an integral part of Petitioner's unitary business, nevertheless, the apportionment by the Department of income from Petitioner's oil and gas production operations is arbi-

trary, capricious and illegal, and is in violation of the express provisions and intent of Sections 71.07(1) and (2), Wisconsin Statutes.

(f) The Department's approach to the determination of Petitioner's income taxable in Wisconsin in effect attempts to impose a tax on activities outside the state which are independent of any of Petitioner's activities in Wisconsin, and to impose a tax upon income from real property located outside the state; such a construction of Section 71.07 would give it a breadth for which there is no basis under the Wisconsin Constitution, thus rendering the statute unconstitutional if so construed.

(g) As the result of the Department's method of determining Petitioner's net income under the Wisconsin Statutes, income from Petitioner's business, operations and properties outside the State of Wisconsin has been subjected to taxation in Wisconsin, all in violation of the due process clause of the Fourteenth Amendment to the United States Constitution, and which constitutes a burden on interstate commerce in violation of Article I, Section 8(3) of the Commerce Clause of the United States Constitution.

(4) *Petitioner's Representatives.* Authorized to appear and act for the Petitioner in relation to the matter here in issue are attorneys Thomas G. Ragatz, of Madison, and Lloyd M. McBride and Paul D. Frenz of Chicago, separate written authorization therefor being herewith submitted; and Attorney Robert E. Tannehill of Petitioner's legal staff. It is requested that all correspondence and other communications in connection with this matter be directed to Attorney Thomas G. Ragatz, P. O. Box 927, 110 East Main Street, Madison, Wisconsin 53701.

WHEREFORE, Petitioner prays that the decision of the Department denying its Application for Abatement be reversed and the deficiencies abated, and that an order be entered determining that Petitioner's reporting of its Wisconsin income for the years in issue on the basis of its separate accounting be affirmed; or in the alternative determining that Petitioner is entitled to deduct all its oil and gas production income as income following the situs of out-of-state property in determining the remaining income to be apportioned.

Respectfully submitted,

/s/ *Thomas G. Ragatz*
Thomas G. Ragatz
Attorney for Petitioner
P. O. Box 927
110 East Main Street
Madison, Wisconsin 53701

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Summary of Alternative Methods of Attributing Income to Wisconsin

Year	State's Hybrid Apportionment		Humble's Wisconsin Separate Accounting		Marketing Function Apportioned Only		Marketing & Refining Apportioned Only		Exploration And Production Separate Business or Allocation to Situs	
	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax
1965	$ 759,371	$ 52,961	($ 821,320)	$ -0-	$ 541,794	$ 37,731	$ 282,383	$ 19,572	$ 310,841	$ 21,564
1966	1,043,395	72,843	(1,159,830)	-0-	316,081	21,931	430,886	29,967	443,520	30,651
1967	1,264,946	88,351	(1,026,224)	-0-	394,993	27,455	490,252	34,123	503,182	35,028
1968	1,464,443	102,316	(919,575)	-0-	833,739	58,167	655,869	45,716	700,086	48,811
Totals	$4,532,155	$316,471	($3,926,949)	$ -0-	$2,086,607	$145,284	$1,859,390	$129,378	$1,957,629	$136,254
	(From Audit Report)		(From Wisconsin Returns)		(From Schedule D)		(From Schedule E)		(From Schedule C)	
Differences With State Audit And:										
a) Separate Accounting			$P,459,104	$316,471						
b) Marketing Apportioned Only					$2,445,548	$171,187				
c) Marketing And Refining Apportioned Only							$2,672,765	$187,093		
d) Exploration And Production As Separate Business Or Allocation To Situs									$2,574,526	$180,217

NOTE: This schedule summarizes the resulting Wisconsin net taxable income and franchise tax liability under four alternative conclusions as to the method for arriving at the net income attributable to Humble's activities in Wisconsin during the years 1965 thru 1968.

1) Separate accounting for Wisconsin marketing activities, as reported in Humble's Wisconsin tax returns.
2) Marketing functional department's net income allocated and apportioned to Wisconsin under the statutory formula, and all other income treated as from separate out-of-state businesses.
3) Marketing and Refining functional departments' combined net income allocated and apportioned to Wisconsin under the statutory formula; and all other income treated as from separate out-of-state businesses.
4) Exploration and Production function's net income treated as (a) a separate out-of-state business, or (b) as income from "mining" allocated to situs, with all other non-allocable net income of Humble apportioned under the statutory three-factor formula.

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APPENDIX I

HUMBLE OIL & REFINING COMPANY

1965 - 1968 Wisconsin Corporation Franchise Tax Audit
Comparison Of Net Income From Marketing Department With Assessed Income From Wisconsin Marketing Operations

Year	Wisconsin Sales[1]	Wisconsin Assessed Taxable Income[2]	Percent Of Net Income Per Dollar Of Sales	Total Marketing Sales[3]	Marketing Net Income - Wisconsin Basis[4]	Percent Of Net Income Per Dollar Of Sales
1965	$12,960,144	$ 759,371	5.9%	$1,985,040,274	$ 81,095,253	4.1%
1966	14,358,059	1,043,395	7.3%	2,115,810,678	48,751,718	2.3%
1967	16,350,330	1,264,946	7.7%	2,350,471,400	53,294,915	2.3%
1968	16,384,760	1,464,443	8.9%	2,512,855,906	105,601,885	4.2%
Totals	$60,073,293	$4,532,155	7.5%	$8,964,178,258	$288,743,771	3.2%

Notes:
1) From State Audit, Page 12 (Exhibit E-3) EXHIBIT # 1
2) From State Audit, Page 1 (Exhibit A-B) EXHIBIT # 1
3) From Petitioner's Schedule D, Page 2 EXHIBIT # 25
4) From Petitioner's Schedule D, Page 1 EXHIBIT # 24

*(Less allowable Federal income tax and contribution deductions.)

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APPENDIX J